October 5 — October 11, 2015 | bloomberg.com

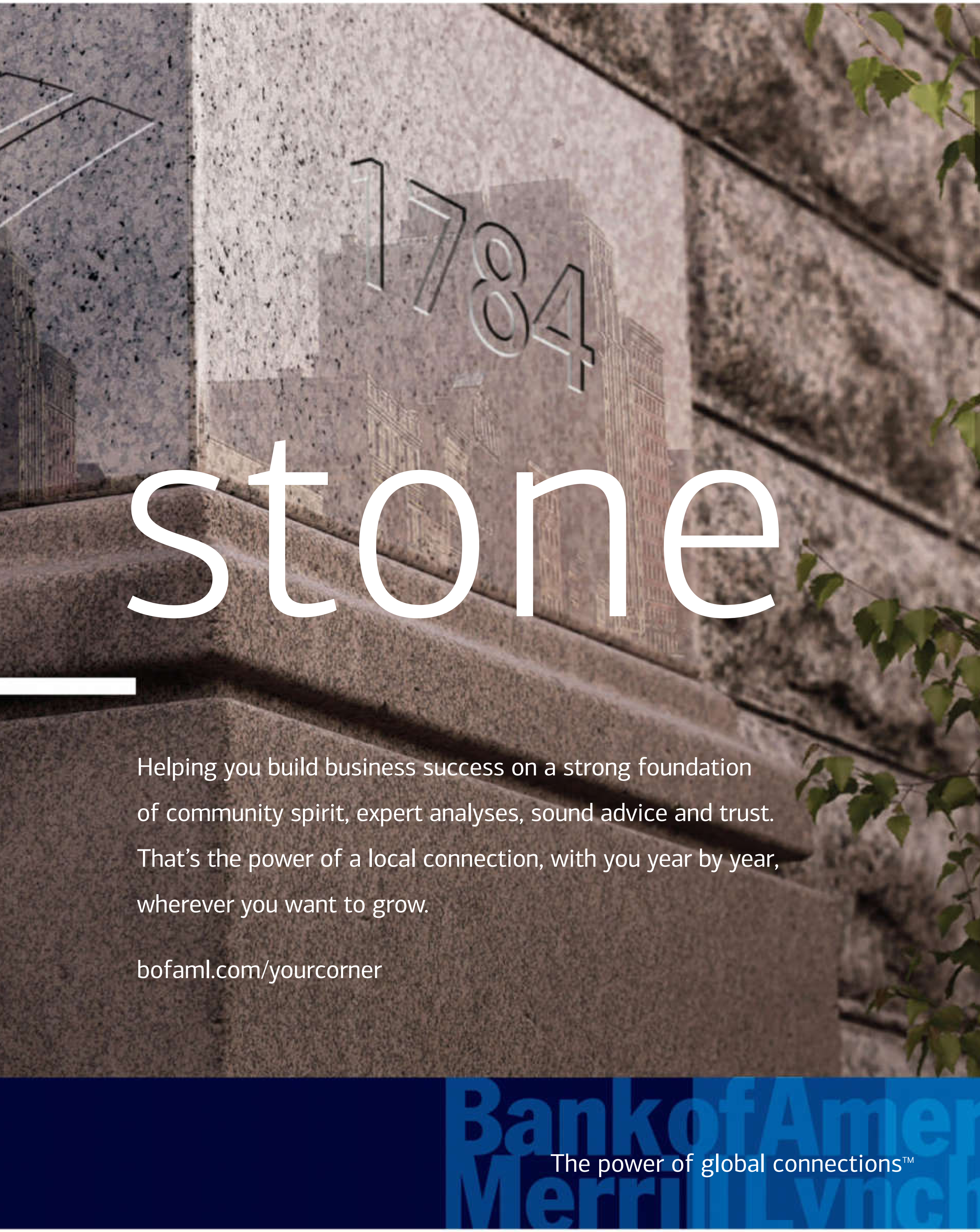
Bloomberg Businessweek

The New Money Issue

Meet the rising class of global hustlers

p49


corner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PHOTOGRAPH BY KA XIAOXI FOR BLOOMBERG BUSINESSWEEK

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Bloomberg Businessweek
October 5 — October 11, 2015

Cover Trail

How the cover gets made

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"The cover is our New Money special issue."

"'New Money' as in people who just got rich?"

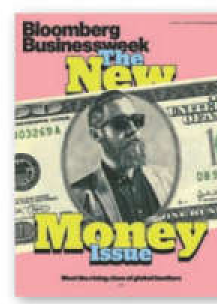
"There is some of that, but also young people in China who are living off their inheritance, a West Coast real estate company that's making a killing selling the millennial lifestyle, and wealthy Bolivians who are splurging on over-the-top architecture."

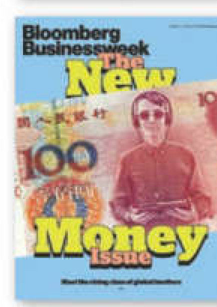
"That's a lot to put on a cover."

"What do you see when you hear 'New Money'?"

"I see the guy standing in line for a $6 artisanal drip coffee, who carefully grooms himself to look like a backup keyboardist for the Black Keys, wearing a $1,100 Neil Barrett blazer that he pairs with brand-spanking-new Converse that he makes sure not to get a speck of dirt on as he steps into his black Uber car on the way to the vanity company he started with daddy's money."

"I sense much hate in you."





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CHINA: PHOTOGRAPH BY JAMES WHITLOW DELANO FOR BLOOMBERG BUSINESSWEEK; MAYWEATHER: ETHAN MILLER/GETTY IMAGES; SANDBERG: DAVID PAUL MORRIS/BLOOMBERG

Interconnected Risks

Supply and Profit

Effective value chain risk management is becoming an increasingly important competitive advantage

Short-term savings can create long-term risk.

If a business is a living thing, its supply chain is the heart—it delivers value and makes it possible for all the integrated parts of the business to thrive. It's also a major expense, and as such it's tempting to look for efficiencies in it. Just-in-time manufacturing, for example, became vogue because it reduced the need for costly inventory. But when your business relies on thin inventory it greatly increases the likelihood that it will suffer the impact of a supply chain disruption, and adds to the costs of it.

"It's not uncommon for businesses to look only at the costs associated with their supply chain, without balancing reliability or recovery needs," says Patrick Daley, Chief Underwriting Officer, Zurich Global Corporate in North America. "We have found that actions taken to drive short-term costs out of the supply chain and improve operational efficiencies can sometimes drive greater risk into the company, increase overall costs and damage shareholder value."

And that's just one aspect of managing what is today a globally interconnected challenge.

Disruptions require resilience

Since 2009, the Business Continuity Institute (BCI), a global organization with more than 5,000 members, has conducted an annual Zurich-sponsored survey, "Supply Chain Resilience." Over that time, results have shown that nearly 85 percent of companies surveyed suffered a supply chain interruption, and more than 50 percent experienced more than one disruption during the same year. These events can be devastating: Zurich's proprietary supply chain event loss database shows that over the past decade nearly 55 percent of value chain disruptions exceed $25 million in costs.

The interconnected nature of risks to supply chains is revealed by closer consideration of what on the surface seem to be innovative improvements. For example, better transportation and logistics, along with increased globalization, enable companies to source materials from virtually anywhere in the world. But they can also result in supply chains that are more complex, more exposed and, therefore, more difficult to manage.

Likewise, long-term agreements with key suppliers and business partners provide stability and enable a company to focus on its core competencies, but also result in greater interdependencies and need for wider approaches to risk management. Even trying to create leverage and lower costs by relying on a single source for a key supply can result in increased vulnerabilities.

"Historically, according to BCI, supply chain disruptions lead to 9 percent lower sales and 11 percent higher costs, and many companies with extended interruptions never recover," says Daley. "These are complex risks that business leaders and risk managers have to be extremely proactive about. When a supply chain is disrupted, both the company and its primary suppliers may be able to recover more quickly if they work together before an event to plan how they will respond. That type of resilience can create a competitive advantage when two businesses are facing the same challenge and one is prepared and the other isn't."

How to address vulnerabilities

Zurich's Supply Chain Risk Assessment and insurance solutions are designed to help companies reduce the incidence of supply chain disruptions and provide insurance protection when they experience a reduction in business output as a result of delayed supplies. "Our proprietary database of nearly 3,000 disruptions collected over the last decade gives us significant insight into the causes and costs of value chain disruptions," says Daley. "We look at nearly 25 areas of risk for each of your critical suppliers to reveal and help you address vulnerabilities that could inhibit your company's ability to respond to today's value chain risk challenges." — *Evan Rothman*

> "Actions taken to drive short-term costs out of the supply chain and improve operational efficiencies can sometimes drive greater risk into the company, increase overall costs and damage shareholder value."


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Opening Remarks

Right Where He Wants It to Be

By Paul M. Barrett

Aghast at the decisions of the last Supreme Court term, conservatives caricatured John Roberts as a leftist. He most certainly is not

With the Supreme Court poised to reconvene the first Monday in October, let's clear the air about last term's supposed turn to the left: It didn't happen.

The confusion is understandable. On June 25, Chief Justice John Roberts led a 6-3 majority that upheld President Obama's health-care reform program in the face of a partisan Republican attack. The next day, the high court vindicated same-sex unions by a 5-4 vote. The two liberal victories created the illusion of something larger and more dramatic, prompting the hyperbolic wing of the Republican Party to condemn the supposed leftward lurch. Curt Levey, president of the Committee for Justice, a right-leaning advocacy group, declared Roberts "dead to conservatives."

That statement reveals a lot more about the intemperance of certain conservatives than the ideological state of the chief justice. On credentials, remember that Roberts has a résumé that would bring tears of joy to Barry Goldwater and William F. Buckley. Nominated by George W. Bush in 2005, he clerked at the Supreme Court for his predecessor, Nixon-appointee William Rehnquist, came of age professionally in the Reagan administration, and represented large corporations at a major Washington law firm. All that's missing is an internship at the Heritage Foundation.

It's in its decisions that the Roberts court really shines for the right. *District of Columbia v. Heller* (2008) established for the first time in the court's 226-year history that the Second Amendment protects an individual's right to own a handgun. In *Shelby County v. Holder* (2013), Roberts wrote a majority opinion that denuded the Voting Rights Act of 1965 and ushered in an era of voter ID laws and other attempts to discourage minorities and the poor from casting ballots. In the 2015-16 session, this tendency likely will recur in cases on race relations, voting, unions, and abortion.

The chief justice's majority opinion in last term's Obamacare case revealed not a conservative-gone-wobbly, but a sophisticated steward of the court's status as an independent institution. Roberts, 60, occasionally steps back from the ideological barricades, not for lack of spine but because he's playing a savvy long game. In June 2012, with the presidential campaign heating up, he cast the decisive vote rejecting an earlier, equally partisan challenge to Obama's Affordable Care Act. A Republican-dominated majority killing a Democratic president's signature legislation in an election year would have invited unflattering comparisons to *Bush v. Gore* (2000), in which a pre-Roberts conservative majority handed the White House to George W. Bush.

But, in overshadowed passages of his

2012 controlling opinion, Roberts cobbled together majorities that curbed the ACA's expansion of Medicaid and reinterpreted the Constitution's Commerce Clause to give the most restrictive interpretation of federal power over the economy since the New Deal-era justices stopped knocking down Franklin Roosevelt's legislation. (Keep an eye on that facet of the opinion; it's a sleeper that at some point will come back to vindicate corporate interests.)

This year, in *Assault on Obamacare: The Sequel* (aka *King v. Burwell*), Roberts again defused an ugly political clash—and not incidentally blunted Democrats' ability to run against an overreaching Supreme Court. Writing for a six-member majority, he rejected a blatant bid to wreck Obamacare. "Congress passed the Affordable Care Act to improve health insurance markets, not to destroy them," Roberts concluded. "If at all possible, we must interpret the act in a way that is consistent with the former and avoids the latter."

When the stakes are even slightly less dramatic, however, the Roberts-led conservative quintet—which includes Samuel Alito, Anthony Kennedy, Antonin Scalia, and Clarence Thomas—asserts itself. Animated by an expansive reading of the First Amendment, the 2010 ruling in *Citizens United v. Federal Election Commission* swept away long-standing

PHOTO ILLUSTRATION BY 731; PHOTOS: JUSTICES: ZUMA PRESS; FACES FROM LEFT: CORBIS (2); COURTESY LIBRARY OF CONGRESS; COURTESY FDR PRESIDENTIAL LIBRARY; BETTMANN/CORBIS; COURTESY NATIONAL ARCHIVES; BRAD BARKET/AP PHOTO

His ideological orientation is unmistakable, 10 years into his tenure as chief justice

precedent, contradicted Congress, and made it easier for moneyed interests to influence the elections. Corporations have generally had a field day before the Roberts court, winning new barriers against consumer class actions and human-rights suits. A study published in 2013 in the *Minnesota Law Review* ranked the 36 justices who've served on the high court from 1946 to 2011 in terms of their pro-business votes. All five of the current court's conservative members appeared in the top 10. Over the entire 65-year period, Roberts and his fellow George W. Bush appointee Alito were labeled most likely to favor business.

Recent gay-rights cases, by contrast, illustrate that jurisprudential trends, like all trends, have their exceptions. Societal attitudes have shifted rapidly toward tolerance of homosexuality, and Kennedy, the "swing justice" on some high-profile ideological issues, has joined a four-member liberal bloc to knock down antigay laws.

But other seeming liberal victories are better explained as mere holding actions. A 5-4 decision in June in a housing discrimination case from Texas provided an illustration. With Kennedy writing the majority opinion, the court ruled that alleged bias victims don't have to prove intentional bigotry; statistical evidence that blacks or Hispanics were harmed may be sufficient. Civil-rights groups celebrated, but this was no breakthrough. It was more like dodging a bullet. Every federal appeals court that had addressed the housing-bias question came out the same way. The justices generally don't explain why they accept cases for review, but it seems fair to speculate that Roberts, Alito, Scalia, and Thomas voted to hear the Texas case but then couldn't persuade Kennedy to come along for a precedent-busting ride.

In the new term, the court will revisit the controversy over whether public universities may consider applicants' race in admissions decisions. The current constitutional interpretation: yes, to a limited degree. Roberts, Alito, Scalia, and Thomas are almost certain to push for a clear no. Kennedy, I predict, will swing conservative on affirmative action in higher education. If I'm correct, look for invocation of a characteristically pithy remark Roberts used in an opinion in 2007: "The way to stop discrimination on the basis of race is to stop discriminating on the basis of race."

Other pending high-profile cases would allow conservative justices to curtail the power of public-sector unions and to revisit the meaning of the fundamental electoral principle of "one person, one vote." The labor case asks whether unions may require workers who aren't members to help pay for collective bargaining. Labor organizers are justifiably girding for a defeat orchestrated by Roberts.

The election case provides the opportunity for the court to say state voting districts should have the same number of eligible voters, as opposed to the same number of residents—including legal immigrants who aren't citizens, undocumented immigrants, children, and prisoners. If the court says relying on total population isn't mandatory, that would likely prompt red states to shift to the eligible-voter approach—a move that would tilt political power from cities to rural areas and therefore constitute a boon for Republicans.

Abortion isn't yet on the high court docket, but odds are it will return before the end of this term. In June the U.S. Court of Appeals for the Fifth Circuit upheld a Texas law that women's health advocates warn would have the effect of shutting down most of the second-most-populous state's roughly 40 remaining abortion clinics. The state law requires the clinics to meet the same standards for equipment and staffing as hospital-style surgical centers. The legal question for the justices would be whether Republican-controlled Texas has created an "undue burden" on the constitutional right to abortion established by *Roe v. Wade* (1973). There's little doubt that, in the chief justice's view, Texas has ample authority to impose the rules it did. If that understanding prevails, the Supreme Court would be another step closer to overturning *Roe*.

Laurence Tribe, the preeminent appellate advocate and co-author of *Uncertain Justice: The Roberts Court and the Constitution*, warns against the entire endeavor of "trying to measure the left/right swing of the Supreme Court by bracketing its annual terms." Lumping decisions together from one April Fool's Day to the next would be no less arbitrary. "This is a set of nine justices whose views can best be represented by vectors pointing every which way," Tribe says.

I suspect Roberts would agree with Tribe's skepticism about term-by-term scorecards. During his confirmation hearing in 2005, Roberts said he had no agenda whatsoever and promised "to call balls and strikes and not to pitch or bat." With respect to Tribe and Roberts, during the latter's decade as umpire-in-chief, conservatives have tallied an impressive enough winning record to suggest something more purposeful than the sum of disparate vectors. Ⓑ

To read Kavitha A. Davidson on football in Los Angeles and Noah Smith on the cost of being rich, go to

Bloombergview.com

A Twisty Way to Help Greece's Banks

The European system goes through contortions. It shouldn't have to

Now that Greece has survived a standoff with its European creditors and a snap general election, it faces another ordeal: reviving its paralyzed banking system. Flaws in Europe's new banking union will make this job harder than it ought to be.

Months of brinkmanship and economic free fall have left Greece's largest banks in a dire state. Losses are expected to wipe out much or all of their equity capital. Deposits are down about 25 percent since the beginning of the year. Lending to nonfinancial companies fell almost 7 percent from January through July, the largest six-month decline since 2009.

Turning things around will require a thorough reckoning. Banks will have a hard time attracting deposits and lending unless their finances are repaired beyond reproach. That's why it's crucial for the European Central Bank to be unsparing in writing down troubled assets and estimating capital needs. No more smoke and mirrors. The banks need capital in the form of equity—money from shareholders willing to shoulder risk.

The next question: Who will supply the capital? Europe's banking union has rules for full-scale bailouts, but following them could be disastrous. They require banks' creditors (including depositors) to bear much of the loss unless special exceptions are invoked. That's right in principle, but in Greece's case, such losses could hurt businesses severely and further damage the economy. The rules also limit the use of public money from the euro area to directly recapitalize banks. Yet the Greek government lacks the fiscal capacity to solve the problem by itself.

There's a workaround. The bail-in rules don't go into force until Jan. 1. This allows the government—with European creditors' blessing—to avoid harming depositors as long as it acts quickly. Also, euro-region officials have devised a way to inject capital almost directly: The European Stability Mechanism has set aside as much as €25 billion ($28 billion) that Greece can use to buy equity in banks, on the condition that shares are deposited into a privatization fund supervised by European creditors and directed largely toward paying the government's debts.

Still, the creative maneuvering hardly reflects well on the banking union's design. There are two lessons. First, banks should have a lot more capital to begin with. That way, the question of who pays for bailouts will be much less likely to arise. Currently the largest European banks have, on average, even thinner equity cushions than their U.S. counterparts. Second, in cases where public money is nonetheless required, European authorities need the power to recapitalize banks directly without resorting to subterfuge.

Europe's banking union was supposed to sever the link between big banks and national governments so financial and sovereign-debt troubles won't reinforce one another like they did during the region's last crisis. Greece shows that the plan has a long way to go.

Paying the Price of Peace in Colombia

It isn't cheap, but it must be done to help end a bloody civil war

An agreement reached on Sept. 23 has the potential to end the longest civil war in Latin America. Yet a lasting settlement in Colombia will depend on economic support that President Juan Manuel Santos will struggle to muster, a pressing reality that Colombia's partners in peace can't afford to ignore.

After three years of off-and-on talks in Havana, the government and the Revolutionary Armed Forces of Colombia (known as FARC) resolved the thorniest issue in negotiations: "transitional justice," or prosecuting those responsible for the conflict's worst human-rights crimes. The two sides agreed to sign a final peace deal by March 23, with FARC to begin disarming 60 days later.

Peace is its own reward, of course, especially after a half-century struggle that has killed more than 220,000 and displaced millions. At the same time, there's a cost to disarming, demobilizing, and reintegrating rebels, paramilitaries, and soldiers. The plan also calls for redistributing land to the rural population and restoring or finding homes for those who've been displaced.

These burdens will hit Colombia as it copes with the plunge in oil prices, the prospect of a rise in U.S. interest rates, and slackening demand from China. Its economy is still growing, but so is its deficit, and the government has just introduced an austerity budget. Santos can't afford cuts that might lead to social unrest: Not all Colombians back the peace deal.

To pay for peace, Santos will have to accelerate the pace of reform, beginning with raising revenue. Colombia's tax take amounts to 20 percent of its gross domestic product, low by regional and global standards. It could recoup as much as 4 percent of its GDP a year just by cracking down on tax evasion.

With peace so close at hand, the U.S. and the European Union must not cut back assistance. Over the past two decades, the U.S. has given Colombia nearly $10 billion to battle a narco-insurgency. The EU has also helped, as have European nations such as Norway, which co-sponsored the peace talks. Healing Colombia's half-century-old wound could be one of the most hopeful developments in the hemisphere in the past decade. Ⓑ

ILLUSTRATION BY MARK PERNICE

Creating a Des

▶ **Beijing pressures herders to move to the cities**

▶ **"Trees don't grow at the edge of deserts"**

Chaogetu, who like many Mongols has only one name, still lives in the house where he was born, a mud-walled three-room shack in a small oasis of Inner Mongolia's Tengger Desert. He cooks over a wood stove and has a one-month-old lamb tethered in his living room to protect it from foxes and eagles. Like his parents, grandparents, and generations before him, the sun-beaten herder sees his fortunes rise and fall with his livestock—5 camels, 12 cows, and about 500 sheep and goats.

The small lakes dotting this arid region of China have been drying up as the desert grows ever bigger. The sandstorms that roll across the land every spring before heading to far-off Beijing and Tianjin have become more frequent. Clouds of stinging grit choke the lungs and darken the skies for as many as three days at a time, forcing Chaogetu to stay inside and taking a toll on his livestock.

A series of bad storms hit Beijing in the years leading up to the 2008 Olympics. "People in Beijing saw the dust storms and said this is a problem that cannot stand," says Christopher Atwood, an associate professor of Central Eurasian studies at Indiana University.

Officials in China's capital blame overgrazing for the desertification and dust storms. Activists and academics say coal mining and large-scale agriculture, plus climate change, are more to blame. Local authorities are leveling fines on ethnic Mongols with large herds, pressuring them to give up their way of life in exchange for subsidized housing in resettlement villages built outside urban centers. Sometime in the next year, Chaogetu may end up moving to Bayanhaote, the nearest city. "It's not fair," he says. "The government takes your land and house and always gives you just a little bit of money. I don't know whether I will be able to live in a city. But I may have no choice." By yearend, the central government plans to finish a four-year-long resettlement of 1.2 million herders into the villages.

The resettlement policy and the Great Green Wall, began originally in 1978 to plant belts of trees between China's

PHOTOGRAPH BY JAMES WHITLOW DELANO FOR BLOOMBERG BUSINESSWEEK

Inner Mongolia's Tengger Desert

deserts and big cities, were accelerated. The tree planting and the removal of the herders' grazing livestock have been credited with slowing the spread of deserts and dust storms; forestry officials say the encroaching desert is contained for now.

Others are less sure. "Their approach to dealing with desertification is 'Oh, let's plant more trees,'" says Hong Jiang, who teaches geography at the University of Hawaii at Manoa. "But that's problematic, because where you have deserts expanding, those places never have had trees in the first place–trees don't grow at the edge of deserts. Lots of trees planted early on have died."

In April, Beijing experienced its worst sandstorm in 13 years. "The country faces a tough battle against encroaching sands," the official Xinhua News Agency said in June, reporting that annual direct losses from desertification amounted to 54 billion yuan ($8.7 billion).

With resettlement, overgrazed land has a chance to regrow, say forestry officials; the herders have to find work at restaurants, factories, or dairy farms. In one relocation village, just outside Bayanhaote, the one-story houses, each with a small courtyard, look tidy. Many residents are still unemployed, says one Mongol, who runs the only restaurant. (He declined to give his name, citing sensitivity surrounding ethnic policy.) "How can we enjoy living this way?" he asks, sitting in his empty restaurant. "We Mongols are supposed to live in the grasslands, with our animals."

Decades of migration from elsewhere in China have left Mongols a minority in their own region. They make up only 17 percent of the population while Han Chinese are 79 percent. In 2011 a Han coal truck driver hit and killed an ethnic Mongol, sparking regionwide protests. Demonstrations have continued since then, especially over pollution from coal mining and chemical refining.

A 2014 study by Peking University professors found that Mongol herders who moved to resettlement villages used at least 50 times more water than they had in their pastoral life. The herders worked as farmers, mainly growing corn and wheat, which need much more ▶

◀ water than their flocks did. "In this arid grassland of China, ecological resettlement policy is ecologically and economically unsustainable," concluded authors Fan Mingming, Li Yanbo, and Li Wenjun. Says Michael Webber, a geographer at the University of Melbourne: "Raising dairy cows is much more water-intensive than sheep that are grazing."

Open-pit coal mining has spurred the spread of the desert. "In order to dig out the coal, you need to pump out the water," says Deng Ping, a campaigner for Greenpeace China. In the process, that water becomes polluted. Coal mining "has destroyed huge areas of grassland and destroyed the water system."

In early September some 200 herders gathered before government buildings in Inner Mongolia's Xilingol prefecture to demand aid to offset losses from drought. When 20 were detained, hundreds of demonstrators demanded their release. Security guards and riot police stopped that protest and others that ensued. "The government isn't taking our land to protect it. They just want it as property to develop themselves," says an ethnic Mongol who declined to give his name. "Their policy is all about sacrificing Mongols." —*Dexter Roberts*

The bottom line Inner Mongolia is under severe stress as new farms and mining suck up water and speed desertification.

Reform

France's Socialists Turn On the Economy Minister

▶ The ex-banker has called for an end to the 35-hour workweek

▶ Macron is "ignorant of what people face day-to-day"

Emmanuel Macron, France's economy minister, was brought into the Socialist government to kick-start growth after three years of stagnation and unemployment now hovering near 10.5 percent. Macron, a former Rothschild banker, has orchestrated tax cuts for business, kept more stores open on Sundays, and helped make labor laws more flexible. In August he suggested lifting France's 35-hour limit on a workweek. Now he wants to end the job-for-life guarantee for civil servants.

Such ideas appeal to business leaders and even the wider public. But many in President François Hollande's Socialist Party don't like Macron's policies. They think the party should be tacking left, not right, to win more votes. Macron is "ignorant of what people face day-to-day," says Martine Aubry, the Mayor of Lille who as labor minister between 1997 and 2000 wrote the 35-hour workweek into law. "He's arrogant," she says, adding that she is "fed up" with Macron, who is not a party member.

Some Socialist lawmakers want Macron fired before voters elect regional assemblies in December. According to a poll for the daily newspaper *Le Parisien*, Hollande's party is set to lose its majority control of the regions. The vote for 13 regional assemblies will be the last major trip to the polls before the presidential election in spring of 2017.

Marine Le Pen, leader of the anti-immigrant National Front and a candidate in the North region that includes Calais and Lille, may lead a winning slate to secure a majority in that region's assembly, which she would then run. Her niece Marion Marechal Le Pen stands a similar chance of winning the South Provence-Alpes-Côte d'Azur region, Socialist territory for 18 years. Macron is "the future scapegoat for the massive beating the Socialist Party is going to take in December," Marine Le Pen said in a radio interview on Sept. 24.

Outside the Socialist Party, the view of Macron is different. About two-thirds of the French support his call to make work contracts the same for both the public and private sectors by dropping the job-for-life perk. Macron is the second-most-popular politician in France behind Bordeaux Mayor Alain Juppé, according to a poll for *Les Echos*, the business daily. His approval rating jumped 5 points in August, to 44 percent. Hollande's rating is 27 percent.

Christine Lagarde, chief of the International Monetary Fund and a former minister in the French government, told *Les Echos* on Sep. 28, "France needs a lot of reform and therefore a lot of Macron's laws."

Hollande, who hired Macron as his economic aide before upgrading him to minister last year, is neither supporting nor condemning him. Asked about criticisms of Macron by Aubry and others at a press conference in Brussels, Hollande simply said: "Silence is golden."

Macron dismisses his opponents, saying the French will keep the Socialists in power if the economy is strong. "I think when people have pudding and jobs they vote for you," he told reporters in London on Sept. 24. "For me, the next election depends on the ability to deliver." —*Helene Fouquet*

The bottom line Two-thirds of French polled like the economy minister and his reform efforts, but Socialist support is wavering.

Budgets

America's Well-Off Show An Aversion to Debt

▶ Some upper-income consumers clean up their balance sheets

▶ "They're making a very rational consideration"

More wealthy Americans say they're reducing debt than at any time in the past decade. The market volatility that prompted the Fed to delay raising interest rates in September may have persuaded high-earners to be more cautious with their finances, says Richard Curtin, director of the University of Michigan ▶

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◀ Surveys of Consumers. Affluent Americans may be saying to themselves, " 'Given what I expect the returns on stock market investments to be, it would be a better use of my money to pay down debt rather than to put it in the market,' " Curtin says. "They're making a very rational consideration."

The surveys picked up on the new thriftiness of the well-off in the U.S. About 15 percent of high-income households, which the survey defines as the top third of all earners, reported that their debt declined in September. People are in the top third of all earners if they have an income of at least $90,000 a year, according to the Michigan survey.

Fed policymakers delayed raising the benchmark interest rate at their September meeting amid concerns that the weakening world economy could threaten the U.S. recovery and slow inflation. Fed Chair Janet Yellen said on Sept. 24 that she and others on the Federal Open Market Committee are ready to raise interest rates later this year.

For some affluent Americans, the Fed's decision to hold off on a rate hike was likely a wake-up call, says Curtin. Consumers may have underestimated the risk that international developments cited by the Fed posed to the U.S., prompting high-earners to look at their finances more critically, he says.

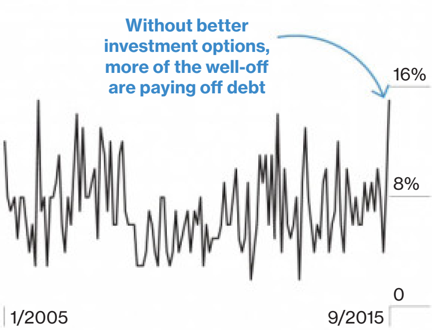
In contrast, the bottom two-thirds of American households, as measured by income, reported that their financial situation got worse during the same period that many affluent households were cutting debt.

Consumers who make less than $90,000 a year may not have spare cash to reduce their debt, says Curtin. "They are much more income constrained, and wage rates have not been going up very much," he says. "A lot of lower-income folks are still trying to rebalance their financial accounts and don't have that much discretion about where to put extra money, whereas upper-income people save each and every month." —*Victoria Stilwell*

The bottom line As the world waits for the Fed to act, cutting personal debt is an attractive alternative to investing in the stock market.

Less Leverage

Share of wealthy households that say their finances are better than a year ago because of lower debt



DATA: UNIVERSITY OF MICHIGAN SURVEY OF CONSUMERS

Quoted

"Once climate change becomes a defining issue for financial stability, it may already be too late."

Mark Carney, governor of the Bank of England, warning about climate change's impact on the world economy on Sept. 29

Propaganda

Separatists of The World, Unite!

▶ **Ultranationalists, too, can join Putin's anti-U.S. crew**

▶ **"We need to pierce American vampires with an aspen stake"**

During the Cold War, the Soviet Union provided arms, money, and intelligence to a global network of political groups that helped promote its agenda and undermine the West. Since the start of the war in Ukraine, the Kremlin has been doing something similar. It's been on a charm offensive aimed at the radical right and left in dozens of countries.

Proxy groups for the Kremlin host these fringe political parties at lavish conferences in Russia and elsewhere to build a sense of unity, stoke anti-American sentiment, and rally support for Russia's policies in Ukraine. At a September conference for mostly left-wing separatists in Moscow, obscure Puerto Rican and Hawaiian independence activists mingled with Northern Irish republicans, Catalan radicals, and rebels from eastern Ukraine. Held in a government-owned luxury hotel, the conference was organized by the Russian Antiglobalist Movement, which is supported in part by the government.

Sporting a cowboy hat, Ramon Nenadich of Puerto Rico told participants that he represented the island's "provisional government," which doesn't recognize U.S. sovereignty over the island. He called the U.S. "the cause of misfortune" in his land. Omali Yeshitela, who is based in Florida and represents the pan-African Uhuru Movement, demanded that the international community recognize "the right of African people to armed self-defense against American imperialism." The movement seeks the economic and political liberation of blacks worldwide.

Sean Carlin, a former member of the Irish National Liberation Army (a post-IRA militant group), said he was glad that Russia, after a post-Cold War hiatus, was again taking the lead in countering the U.S. "Russia is trying to reestablish links with left-wing and separatist movements it used to maintain in the past, because you can see what the West is doing in the Middle East and southeast Europe" (he means Ukraine). Carlin spent eight years in prison after he was convicted in Belfast for kidnapping and illegal arms possession. He says the case was politically motivated.

Fyodor Biryukov, a top official in Rodina (Motherland), a far-right Russian party, spoke at the conference. He compared the U.S. government to a "gang of vampires sucking blood from its own people and the rest of the world." The audience burst into applause when he said, "We need to pierce American vampires with an aspen stake."

Biryukov also spoke at a conference

held for far-right politicians in St. Petersburg last spring. Participants included parliamentarians from Greece's ultra-right-wing Golden Dawn party and Nick Griffin, former leader of the anti-immigrant British National Party.

Biryukov says he sees no contradiction in reaching out to the extreme opposites of the political spectrum: "We should welcome everyone who opposes Washington. The division into right and left is obsolete." He also says he doesn't mind inviting separatists, despite Russia's own problems in Chechnya, where militants fought two bloody wars with the Russians in an effort to win independence. "Separatism is just a tool, like a handgun. It's only important who holds it," says Biryukov.

Anton Shekhovtsov, an expert in right-wing movements at London-based public policy researcher the Legatum Institute, says support of the radicals helps promote the Kremlin line about Ukraine, Syria, and other crucial issues; legitimizes the government in the eyes of Russians by hosting these foreign friends of Moscow on Russian television; and undermines Western liberal democracy. Putin's regime would be happy to work with more mainstream, openly pro-Russian politicians such as former Italian Prime Minister Silvio Berlusconi, says Shekhovtsov, "but there are fewer and fewer of them these days." Berlusconi recently went with Putin to Crimea, defying the European Union's rejection of Russia's annexation of the peninsula.

Biryukov says Russia's most powerful ally in Europe is the newly formed European Alliance for Freedom, a party that unites the continent's right-wing, anti-immigrant, and Euroskeptic groups. The flagship of the alliance is France's National Front, which last year got a loan of €9 million ($10.1 million) from a small Russian bank. Russia's Ukrainian policies get vocal support from the party's leader, Marine Le Pen. Biryukov also says Russia values Jobbik, a major Hungarian right-wing party that may one day be part of the government of that EU member state. Says Vladimir Frolov, a Russian political analyst: "The main objective is to destroy the consensus on Russia in Europe and promote the Russian narrative on global issues."
—*Leonid Ragozin*

The bottom line The Kremlin is building a network of fringe groups to support its policy in Ukraine and fan anti-American sentiment.

Education

Buying a Diploma Is Easy If You Can Pay Up

▶ **Around the world, the sale of degrees is hurting economies**

▶ **"We have public servants who cannot manage simple paperwork"**

Mariam Malak, a 19-year-old from a village in southern Egypt, had near-perfect grades in high school and dreamed of becoming a doctor. But when the results of the nationwide graduation exam were released in July, the honor student was told she had scored zero, failing to answer a single question on all seven tests she took.

KHALED DESOUKI/AFP/GETTY IMAGES

Malak has another theory: Her test papers were swapped for those of someone who paid a bribe or used connections to get a high score. The government says it analyzed the handwriting on the exam papers where she had gotten zeros and concluded she wrote them. Undeterred, Malak is seeking a court order for an independent handwriting review. "We are fighting this on behalf of all students who have suffered injustice in the Egyptian educational system," says her lawyer, Ihab Ramzi. "This case is just an example of the rampant corruption inside the Ministry of Education." The ministry didn't respond to calls from Bloomberg.

Malak is now a heroine to Egyptians fed up with bribery and nepotism. Tens of thousands of people have posted messages of support on Facebook and on an "I Believe Mariam Malak" Twitter feed. Celebrities are offering to pay her tuition at a foreign university. Egypt ranks a below-average 94th among 175 nations worldwide in an annual survey by the anticorruption group Transparency International. Some 67 percent of Egyptians surveyed by the group in 2013 said the education system was corrupt. "Corruption can be found at all levels of education systems" in scores of countries worldwide, Transparency International wrote in its 2013 report, citing everything from bribes to teachers to faked test scores and bogus dissertations.

Corrupt schools not only hurt bright students whose families can't or won't pay bribes, they also cause widespread economic harm, says Stephen Heyneman, an emeritus professor at Vanderbilt University and former World Bank official who has studied corruption in education. Income inequality is an obvious result, as poorer students are denied a shot at credentials that could help them move up the ladder. Heyneman, who has studied the topic in the former Soviet republics in Central Asia for the past decade, says some multinationals operating in the region give special tests to job candidates to separate legitimate graduates from "those who bought their degrees" from corrupt local institutions. Candidates who pass the tests get placed in extended apprenticeships to verify their skills. Because such screening is expensive, many companies try to avoid hiring locally and bring in expatriates for key positions, limiting opportunities even for well-qualified graduates.

"We are fighting this on behalf of all students who have suffered injustice in the Egyptian educational system."
—*Ihab Ramzi, Mariam Malak's lawyer*

Students who get degrees through bribery or nepotism can likely land a job with a government agency or company in their country. That's the case in Ukraine, says Ararat Osipian, a U.S.-trained Ukrainian economist who studies educational corruption there. "We have public servants who cannot manage simple paperwork," he says. Bright but less affluent young people often end up in menial jobs, Osipian says. "It's a terrible waste of human capital."

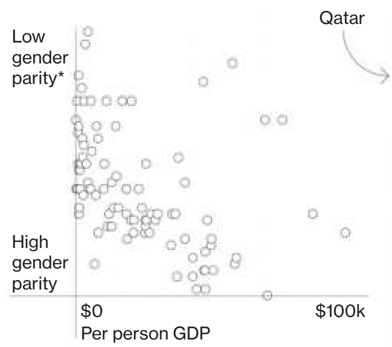
Wasteful, and maybe even ▶

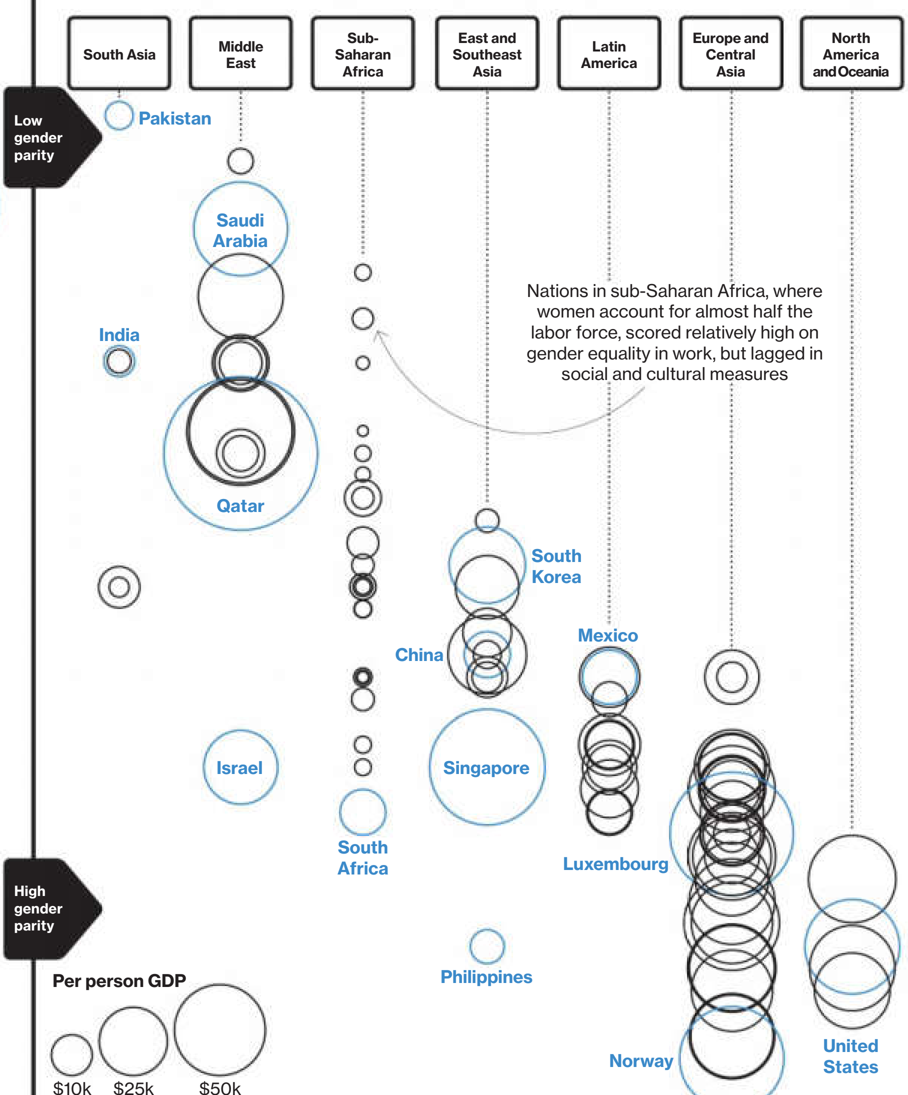
Gender and GDP

By Dorothy Gambrell

Parity's Potential

If the world's women were offered the same economic opportunities as men, $28 trillion would be added to global gross domestic product by 2025, according to the McKinsey Global Institute. The chart at right shows that many economies are barely tapping women's potential. Below, a regional look at the problem.





*GENDER PARITY SCORES ARE BASED ON 15 INDICATORS THAT MEASURE EQUALITY IN WORK, SUCH AS LABOR FORCE PARTICIPATION, AND SOCIAL EQUALITY, INCLUDING POLITICAL REPRESENTATION. DATA: McKINSEY GLOBAL INSTITUTE

◀ life-threatening. The head of Bogomolets National Medical University in Kiev was removed last year after he was accused of accepting bribes to inflate student grades and for handing out medical degrees to the unqualified. The U.S. and European Union nations don't recognize Ukrainian medical degrees.

In 2011 several administrators at the Pirogov Russian National Research Medical University in Moscow were removed after government inspectors discovered that two-thirds of more than 700 slots for full-scholarship students were filled by "ghosts," who either didn't exist or hadn't applied to medical school. The slots, intended to be tuition-free, were then sold to applicants for up to $14,000. Andrei Kamkin, a physiologist who was named rector after the scandal, told the RIA Novosti news agency last year that he fired professors who took bribes and expelled students who had been allowed to retake exams numerous times until they passed. "We realized the danger of letting ignorant students graduate and become doctors," he said.

Raising educators' salaries, often seen as a way to reduce bribery, may not help once corruption has taken root, says Izhak Berkovich, an education professor at the Open University of Israel. In a study published in September, Berkovich compared fourth graders' scores on an international math and science exam in 45 countries. The lowest scores, he found, tended to be in countries that were ranked by Transparency International as relatively corrupt but that also had relatively high per capita spending on education. Injecting money into a crooked education system, he wrote, is like pouring fuel on a fire: "Institutionalized corruption is likely to spread."

In some countries, including some in Central Asia, Heyneman says, even the best students have trouble pursuing advanced degrees or getting jobs abroad. "Their graduates have a poor reputation," he says. "Their professionals aren't trusted."

—Carol Matlack, with Salma El Wardany and Ahmed Feteha

The bottom line Corruption in education can weaken a country's economy, worsen income inequality, and produce unqualified doctors.

Edited by Christopher Power
Bloomberg.com

October 5 — October 11, 2015

Long Live the King

We mean the one with the funny crown

JASON MERRITT/WIREIMAGE/GETTY IMAGES

▶ **Burger King's tightfisted managers crank out quirky marketing suited to the Digital Age**

▶ **"They're generating an enormous amount of publicity at a very modest cost"**

On the night of the Floyd Mayweather-Manny Pacquiao fight in Las Vegas in May, most **Burger King** franchisees were unaware their brand had found a way to advertise during the commercial-free event, which drew a record 4.4 million pay-per-view sales, almost double the previous high, and was viewed by millions more worldwide. So when the King, the chain's robed mascot, emerged into the MGM Grand's arena just off Mayweather's left shoulder, Shoukat Dhanani's phone started to light up. His company, **Houston Foods**, owns about 460 Burger King restaurants, and he represents his fellow franchisees on the company's marketing council. "Everyone wanted to know what was up with the King," he says. Besides the millions of viewers globally, within hours the King's appearance in Mayweather's entourage alongside Justin Bieber was all over **Twitter** and **Facebook**, generating big-time buzz for the restaurant chain.

Media types speculated that Burger King paid Mayweather $1 million to pull off the stunt, a fraction of the tab for a 30-second Super Bowl ad. "They're spending that money very wisely," Dhanani says. "What we used to spend and what we used to get, and what we spend now and what we get, it's a big difference."

Burger King, which counts Bill Ackman and Warren Buffett as two of the largest shareholders in its parent company, **Restaurant Brands International**, has developed a knack for viral advertising. Under the management of its famously stingy controlling shareholder, **3G Capital**, since 2010, the chain has managed to muscle into the daily conversations on social media that increasingly define pop culture. Franchisees say the buzz has translated into higher restaurant sales. And the company is doing it for far less than what **McDonald's** spends on advertising.

"Burger King has really found a way to get attention by doing the unexpected and somewhat irreverent," says Tim Calkins, a marketing professor at Northwestern University's Kellogg School of Management. "They're generating an enormous amount of publicity at a very modest cost." ▶

◀ About a month after the King's surprise appearance at the Las Vegas fight, the mascot again popped up at the Belmont Stakes, in the private box of trainer Bob Baffert, before American Pharoah ran for the first Triple Crown in almost 40 years. Because the horse had become a celebrity, Burger King marketers figured—correctly—that TV cameras would pan to Baffert before the race, again putting the King in the sight of millions and sparking social media buzz. The appearance reportedly cost Burger King only $200,000, which Baffert donated to charity.

4:1

The size of McDonald's estimated U.S. advertising fund vs. Burger King's

The King's horse race cameo was partly about selling more chicken. A few days before the race, the company had rolled out national TV ads featuring the King to promote its 10 chicken nuggets for $1.49 deal. "We strive to create moments for Burger King to fall into organic conversations about what's current and what's trending," says Axel Schwan, Burger King's global chief marketing officer. "Our goal is to enmesh the brand into the fabric of pop culture."

Burger King likes being edgy, Schwan says, and it has proved that it doesn't mind doing things that might make other brands blush. In August, as the company pushed a new spicy version of its chicken fries—a cult favorite the chain returned to the menu after a flood of social media requests—it tweeted a picture of what appeared to be a stack of pornographic magazines. The skin books, their cover images blurred, were set next to a box of Fiery Chicken Fries, and the tweet read: "Hotter than your summer reading list. #fierychickenfries." Less than a week later, a similar tweet featured blurred-out images of bikini-clad women with this message: "Hotter than your browsing history."

In an age when office chatter has moved from last night's TV episode to the latest viral video, part of Burger King's marketing advantage has been its willingness to move quickly to exploit a constantly churning Internet news cycle. After the company reentered France in 2013, following a 16-year absence, social media there were besieged with negative comments from French customers complaining about long lines at the restaurants. Burger King didn't waver in the face of the apparent customer service crisis. Instead, it printed some of the "angry tweets" on construction panels at the new locations as proof it had heard the negative feedback. That gambit generated millions of retweets, won a marketing award, and again showed Burger King to be a brand that isn't afraid to ignore conventional wisdom. "The better it is you understand what you stand for, the easier it is to react quickly," Schwan says.

A knack for attracting social media attention has allowed Burger King to punch above its weight in the Twitterverse

McDonald's remains the world's largest restaurant company, and its sheer size has pushed Burger King to take marketing risks to stay competitive. In 2014, McDonald's had roughly five times Burger King's ad budget, with money for Super Bowl ads and sponsorships of the FIFA World Cup and the U.S. Olympic team. But Allen Adamson, North American chairman of branding firm Landor Associates, says size advantage doesn't go as far as it used to because of social media. "If you have the right spark, it will generate more buzz than paid media," he says. "Good content travels so powerfully that every year the playing field gets more level."

In June 2014, Josh Kobza, Burger King's chief financial officer, said the company would rely more heavily on data to make sure its marketing was cost-effective and reaching the right customers, and was "shifting channels toward more digital and social media." David Palmer, an analyst at RBC Capital Markets, recently said Burger King's marketing had "been among the most effective in U.S. fast food" in the past few years. Besides ad agencies **David**, **RockOrange**, and **Pitch**, Burger King uses marketing shop **Code & Theory** for social media and **Scout**, a sports-focused subsidiary of Horizon Media, for planning the King's high-profile boxing and racing gigs.

Relying on cheaper social marketing fits nicely with 3G's management approach. In the fast-food industry, it's common for franchisees and company-owned restaurants to pay about 4 percent of gross sales each month into an advertising fund that's administered at the corporate office. That means that in the U.S., McDonald's had about $1.42 billion in its marketing pot in 2014, funded mostly by franchisees. McDonald's corporate owns about 19 percent of its restaurants worldwide, and the company reported spending $808 million on marketing last year. But after 3G Capital took over Burger King, it started selling off hundreds of company-owned restaurants to reduce costs. Five years later, the parent owns only 52 restaurants, all in the Miami area. So it pays next to nothing for advertising out of the corporate coffers. Last year, Burger King collected an estimated $345 million in U.S. advertising money, less than a quarter of the haul at McDonald's.

The huge ad budget differential is one reason Burger King is likely to continue rolling out marketing stunts such as its open letter to McDonald's in August, asking its longtime rival to help it create a hybrid burger from the two chains' ruling sandwiches; its sale would benefit charity. For the price of two full-page newspaper ads, Burger King and its hypothetical "McWhopper" lit up the Twitterverse and quickly generated chatter around its brand across social media. "It was perfect guerrilla marketing," says Landor Associates' Adamson. "There was nothing McDonald's could have done. They were instantly checkmated." —*Craig Giammona*

The bottom line Burger King's mascot stunt at the Belmont Stakes cost only $200,000 but sparked a social media frenzy worth more.

Retailing

Getting By With Fewer Stores in China

▶ Merchants try showrooming to spur Internet sales

▶ "It's what you can't get from just pure online shopping"

Chinese gymnast Li Ning wowed the world with one of the highest double pikes in Olympic history to clinch a third gold medal at the 1984 Games in Los Angeles. Now chairman of the eponymous sporting-goods manufacturer and retailer **Li Ning**, he's counting on winning fans and selling products with a different tactic: showrooming.

His company operates more ▶26

Energy Why Shell Gave Up on the Arctic

Environmentalists claimed victory on Sept. 28 when Royal Dutch Shell threw in the towel on drilling in the Alaskan Arctic. But there's a lot more behind the decision than green protests. ——*Mark Glassman and Paul Barrett*

Crude price per barrel

3/31/14 $101.58
6/30/14 $105.37
9/30/14 $91.16
12/31/14 $53.27
3/31/15 $47.60
6/30/15 $59.47
9/30/15 $45.31

Expensive promises to keep

Despite plunging oil prices, Shell has pledged to maintain its annual dividend of

$1.88

per share. And after completing its buyout of BG Group, it's committed to begin in 2017 a stock buyback worth

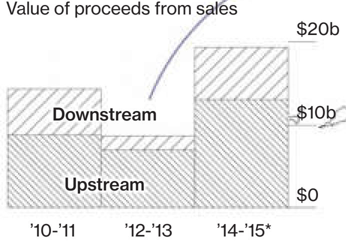
$25b

Sell, reduce, cut

Keeping the commitment means trimming the company in several areas:

❶ Sell assets

Value of proceeds from sales



❷ Reduce capital investment in 2015 by

20%

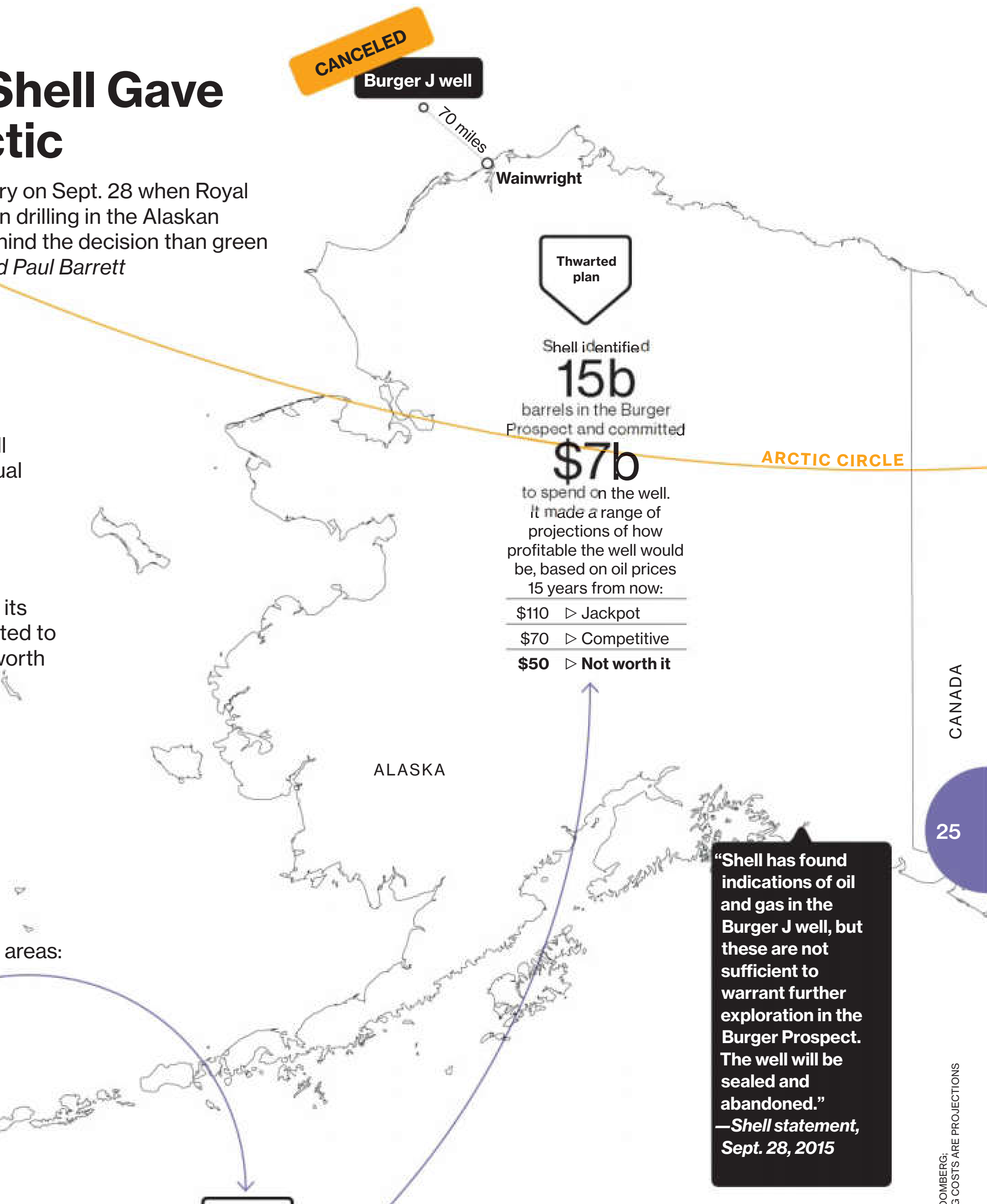
after a similar cut last year

❸ Lower operating costs in 2015 by

10%

❹ Cut jobs in 2015 by

6,500



Thwarted plan

Shell identified

15b

barrels in the Burger Prospect and committed

$7b

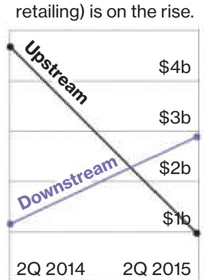
to spend on the well. It made a range of projections of how profitable the well would be, based on oil prices 15 years from now:

$110	▷ Jackpot
$70	▷ Competitive
$50	**▷ Not worth it**

"Shell has found indications of oil and gas in the Burger J well, but these are not sufficient to warrant further exploration in the Burger Prospect. The well will be sealed and abandoned."
—*Shell statement, Sept. 28, 2015*

Income inequality

Upstream (oil exploration and drilling) profits are tanking, but income from downstream operations (refining and gas retailing) is on the rise.



Looking forward

Even without the Arctic, Shell's planned takeover of BG Group next year will make it a significantly larger energy producer.

1	The new company's rank in liquefied natural gas production among international oil companies
28%	Increase in Shell's oil and natural gas reserves as a result of the deal
557k	Barrels of oil per day to be produced by BG's Brazil properties in 2020, according to Jefferies
$2.5b	Annual cost savings expected by the merging companies by 2018

PHOTOGRAPH ILLUSTRATION BY CREDIT TK DATA: SHELL, BG GROUP, JEFFERIES GROUP, BLOOMBERG; *VALUE OF ASSET SALES IN 2014-15 AND CHANGES IN CAPITAL INVESTMENT AND OPERATING COSTS ARE PROJECTIONS

◀ than 1,200 brick-and-mortar stores where customers can shop and buy as usual, but in some they can also inspect and try on—but not take home—showcase products such as the latest Xiaoqiang basketball shoes or the app-connected Rouge Rabbit and Furious Rider smart running shoes. Instead, would-be buyers of those items are directed to the Internet. The showrooming strategy for those online-only goods, which were introduced in late July, drew sales of 22 million yuan ($3.5 million) in the first month, and may help the Beijing-based company reverse three straight years of losses.

Li Ning is among a handful of companies giving showrooming a try in China, where the practice is rare. In the U.S., some Web retailers such as eyeglass maker **Warby Parker** operate full-time showrooms to let consumers get physical with their wares; others, such as clothier **Frank & Oak**, have occasionally opened pop-up or seasonal stores to boost sales. But Li sees the strategy as a way for his Chinese company to improve inventory management. That's a particularly complex exercise on the mainland, where there are about 140 cities with more than 1 million people and brick-and-mortar retailers often must have distribution facilities spread across large distances.

"In the past, we'd sell flagship products in physical stores," says Li, who founded his business in 1990. "When we sell them online now, we have thousands of shops to promote the products, with only one warehouse behind us."

Distributing goods from a single warehouse cuts storage and handling costs, resulting in savings that can be passed on to customers, Li says. It can also reduce the time the company holds inventory, which ties up capital. The company has been trying to improve stock management to boost profitability.

Retail sales over the Internet reached $165 billion in China last year, accounting for almost a fifth of the global total, according to researcher Euromonitor International. Still, Li is moving forward slowly with showrooming, so as not to lose traditional customers in the process. "There are still many people who do not shop online," he says. "We need to serve them."

Appliance maker **Haier Electronics** isn't waiting. It plans to strip inventory from 3,000 of its 38,000 stores across China, with the first 125 of them outfitted with display-only merchandise by the end of the year, the company says.

In Haier's reformatted stores, sales staff help customers make online purchases. Goods such as refrigerators and washing machines can be paid for with cash at the shops, and delivery can be arranged through Haier's Goodaymart logistics unit, which fulfills sales made online. The goal is to provide those buying digitally a better customer experience, says Zhou Yunjie, chief executive officer. "Customers need to feel and see the products," he says.

Consumers seem to like the changes so far. The existing stockless stores have logged a 7 percent to 8 percent increase in sales, Zhou says. By comparison, sales at stores that haven't been converted have declined as much as 20 percent. Besides having lower inventory levels, Zhou says he expects his stockless stores will be able to reduce staff costs by about 30 percent.

"The showroom approach might be a good way to boost sales in China in the face of rising rental and labor costs, ongoing logistics issues, and the boom in Internet retailing," says Fangting Sun, a senior analyst with Euromonitor. The tactic may also be helpful in winning more customers in smaller cities, "especially those in the rural areas who want to catch up with the latest trend," she says.

By showing hot items inside stores that require online ordering, "we have thousands of shops to promote the products, with only one warehouse behind us."
—Chairman Li

Luke Grana, CEO of online clothing retailer **Grana**, which has a showroom in Hong Kong where it's based, says the practice allows his company to mix the best of online and offline shopping. "Coming in, they can have fresh lemonade and we can talk to them," he says. "We can suggest styles and they can get their fits right. It's what you can't get from just pure online shopping."

Euromonitor's Sun says China's online shoppers have begun a shift from buying mostly necessities to choosing favorite items and specialty products, "thanks to rising disposable incomes and a wider range of product offerings." So the showroom approach in China may also be suited for such merchandise as home goods, furniture, and beauty care items.

"The future is not a lot of stores," says Bruce Rockowitz, CEO of Global Brands Group Holding, a Hong Kong manufacturer of fashion goods under brands it controls, including Juicy Couture and Frye. "It's going to be a future of showrooms in key places and stores that showcase the brands and build the image." *—Annie Lee*

The bottom line Chinese retailers are cutting inventory costs with goods displayed in stores that must be bought online.

Sports

NFL Athletes Get Ready To Sell Their Stories

▶ **A new media company will create programming about players**

▶ **"It's a chance for fans to see us outside of the white lines"**

The NFL Players Association is getting into the content business. The union, which represents 1,800 football players, has formed Athlete Content & Entertainment, or **ACE Media**, to produce programs across multiple platforms featuring athletes from all sports.

The goal, according to Scott Langerman, ACE Media chief executive officer, and Ahmad Nassar, president of **NFL Players Inc.**, the union's for-profit licensing and marketing arm, is to reach beyond jersey-sporting football fans and tap into audiences drawn to stories about the players. "There is, and I don't think I'm overstating it, an unlimited supply of stories and interest," says Langerman, a former Vox Media executive.

The company, announced on Sept. 21, plans to create scripts for original programs, as well as reality series using various formats, including animation and audio. Ideally, says Nassar, distributors, publishers, and broadcasters such as Derek Jeter's online Players' Tribune, where athletes themselves write first-person accounts, will come calling. Players' Tribune already has signed on as a distribution partner along with **BET** and websites Bleacher Report and 120 Sports. ACE programming will air on BET by yearend, according to Nassar. He declined to offer any specifics on the programming or the deal. Nassar says ▶

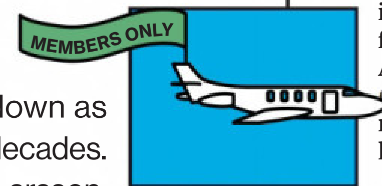
BOB METELUS

Briefs

By Kyle Stock

Into the Sunset

Ralph Lauren said he would step down as CEO of the fashion empire he built over five decades. The 75-year-old design icon tapped Stefan Larsson, president of Gap's Old Navy brand, to succeed him. Lauren will stay on as executive chairman and chief creative officer while Larsson tries to reverse a sales dip. *Volkswagen* drew up a plan to fix some 11 million diesel-powered cars that were rigged to dupe emissions tests. The carmaker didn't disclose whether the repairs would affect the mileage or performance of the models. The number of lawsuits in the U.S. against the company claiming fraud has topped two dozen. Crimped by swooning oil and gas prices, *Chesapeake Energy* dismissed 15 percent of its 5,000 employees. It took a $55.5 million charge for the downsizing, which comes on the heels of a $4 billion writedown in August as it readjusted the value of its oil fields. *Keurig Green Mountain* began selling a device intended to crack the market for soda and other cold beverages, as its coffee pod business struggles with a rash of competitors. The company took six years to develop the Keurig Kold, which is priced at $370. Coca-Cola and Dr Pepper are backing the strategy with proprietary pods that will compete directly with SodaStream International. *Whole Foods Market* said it would cut 1,500 jobs as it tries to lower prices companywide and upgrade technology. The reduction is equal to about 1.6 percent of the workforce at the grocer, which has been known for relatively generous pay and benefits. About 69 percent of store employees are full-time.



Wheels Up, a membership-based private aviation company, gets $115 million in funding. The New York startup owns a fleet of 35 nine-seaters and flies to 5,000 airports in North America.

Price for the premium Signature Model X SUV from **Tesla**. The company hopes to sell 50,000 of the vehicles annually. More affordable versions will be available in a few months.

$132k

CEO Wisdom

"We now have an opportunity ... to build Ryanair.com not just as the airline's website, but as a kind of Amazon for travel in Europe. ... We want to disintermediate all the disintermediators."

Ryanair CEO **Michael O'Leary** explaining the expansion of his booking platform

other potential partners include the league's media properties—NFL Now, NFL Network, and NFL.com.

Negotiating for players seeking media opportunities is easier for the union than it is for athletes on their own, because it holds the group license rights for some 1,800 football players. Advertisers who want to use six or more NFL players in a commercial venture must negotiate a license with the union.

With ACE, the players' association is operating as something more than a sports union. Increasingly, it resembles the **NFL** itself, which generates more than $12 billion annually and has been in the content business for decades. Nassar says the players' union currently is the sole investor in ACE Media, but he's held talks with undisclosed prospective investors. "We wanted to talk with potential investors from a gut-check and sounding-board perspective to see whether our hypothesis is right," he says. ACE will also be supported by corporate licensees, including **Nike**.

The company will provide players for existing programs, such as the Bleacher Report's *Take It to the House*, a reality show sponsored by Best Buy that features athletes' homes. In one episode negotiated by ACE, cameras follow San Diego Chargers defensive end Corey Liuget as he shops for a home.

Eric Winston, president of the players' union and an offensive lineman with the Cincinnati Bengals, says ACE will give athletes the media opportunities they've been seeking. "Fans want access. We asked, 'Why are we waiting on someone else to do this?'" Winston says. "We'll see what kind of life form it takes. It's not just a chance for Players Inc. to deliver a new vertical revenue stream, it's a chance for fans to see us outside of the white lines."

A media company is a creative way for players to tap into the demand for all things football and reach new fans, says Paul Swangard, a lecturer at the University of Oregon's Warsaw Sports Marketing Center. However, he says, "it will still come down to the quality of the content." —*Scott Soshnick*

The bottom line With its new media company, the NFL Players Association is moving beyond its traditional role as a sports union.

Edited by James E. Ellis & Dimitra Kessenides
Bloomberg.com

MATTHEW LLOYD/BLOOMBERG

▶ **Counties fell for a pitch on tax-free bonds for prisons and got nailed with millions in IRS fines**

▶ **"I trusted the people, or we wouldn't have gone forward with it"**

James Parkey spent more than a decade crisscrossing the U.S. selling poor counties on a way to get rich quick. He'd help local governments issue tax-free bonds to build private prisons that would rent beds to the federal government, mainly to hold undocumented immigrants. Parkey's model for financing lockups, which he promoted with help from a team of bond dealers, consultants, and lawyers, led to a boom in prison construction. While the jails succeeded in many places, almost two dozen defaults followed in cities and counties from Florida to Montana as the prisons struggled to fill beds amid the sudden glut. Then the IRS got involved.

As of July, eight detention center deals were being investigated over their tax-exempt financing, according to an IRS document. Several other counties in Texas and Arizona have settled with the government, paying as much as $1.9 million and refinancing their prisons with taxable debt, including at least three developed by Parkey and his network. In most cases the deals were "basically snake oil," says Bob Libal, executive director of Grassroots Leadership, a nonprofit in Austin opposed to private prisons.

Parkey, an architect, got into the correctional facilities business in the 1970s, when Texas ordered counties to rebuild their crumbling jails. In the 1990s he founded **Corplan Corrections** in Irving to focus on prison design and development. "You do one, you do two, you do 10, you do 20, and I guess you're an expert," says Parkey, who declined to comment on tax issues. In the wake of the Sept. 11 terrorist attacks, he assembled a team to visit counties eager to kick-start their economies. It included two bond underwriters, a feasibility consultant, a Houston-based builder, and a rotating cast of private prison operators, including **Emerald Correctional Management** of Shreveport, La.

They provided local officials with feasibility studies suggesting the facilities would pay for themselves with rental revenue from the U.S. Marshals Service and U.S. Immigration and Customs Enforcement. Counties were urged to build jails with two to three times more capacity than they'd need for local inmates. They also were advised to act fast to nail down that business, lest they "allow other counties or private developers to capture the market," according to a report given to prospects by Parkey's team. Local development authorities, some created specifically for the detention deals, owned the projects and issued bonds for them whose interest was exempt from federal taxes.

The bond offering statements included a warning indicating that the IRS might take issue with the setup. They said the tax-exempt status could be "adversely affected" by the decision to

FROM LEFT: GETTY IMAGES; QUAD-CITY TIMES/ZUMA PRESS. DATA: BUREAU OF JUSTICE STATISTICS

Guess who pays when the government buys duds 32

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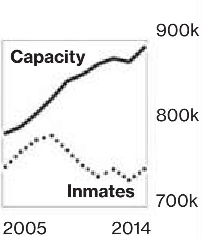
house federal inmates at the jails. Since 1986, the federal use of projects built with tax-exempt bonds has been limited to 10 percent, to prevent bondholders from being paid with taxpayer dollars as well as getting the tax-free subsidy. But in 1998 the IRS allowed a single jail project to go ahead with tax-exempt financing because the federal use was intended to be short-term. Since then, developers have argued that their prisons should also qualify for tax exemption. Some have used nonrenewable short-term federal contracts to bolster their claims, according to Mark Scott, the former director of the IRS's tax-exempt bond division. "They pushed the envelope hard," he says.

Polk County, one of the poorest in Texas, was eager to ink a deal with Parkey. In 2004 it created the IAH Public Facility Corporation to issue $49 million in tax-exempt bonds to build a jail to house immigrant detainees. Today, hundreds of the 1,054 beds in the detention center are empty. "I trusted the people, or we wouldn't have gone forward with it," says Tommy Overstreet, a county commissioner who voted for the facility. "At that particular time everything was go, go, go."

The Polk facility was initially a boon for the county, generating almost $1 million a year in revenue. Then things changed. The federal government stopped sending as many inmates amid allegations of poor medical care, insufficient food, and excessive use of solitary confinement. The population dropped further after President Obama issued executive orders in 2012 and 2015 suspending detention and deportation for millions of undocumented immigrants. In May 2014 the IRS served notice that it considered the jail's tax-exempt financing improper. The county development authority, which has settled with creditors over $49 million in outstanding bonds, agreed in September to pay the IRS $980,000 to resolve the case.

Parkey blames the woes in Polk and other counties on circumstances unique to each prison and to dwindling immigration enforcement. "We build them, design them, help communities to get the right operator with the right use, and try to make them successful," he says. "We've had good luck with that, and we're proud of it." The IRS declined to comment on the Polk case or any others, saying it's prohibited by law from discussing specific taxpayers. The underwriters say their decisions were informed by attorneys' opinions. "With regard to the tax exemption of bond issues, we rely on recognized bond counsel's opinion that the interest on the bonds will be tax-exempt," says William Sims, managing principal at Herbert J. Sims & Co., a firm in Fairfield, Conn., that worked with Parkey on the Polk County deal. The law firm that advised Sims, Jenkens & Gilchrist, was dissolved in March 2007 after reaching a nonprosecution agreement with the Department of Justice in which it admitted that it developed and marketed tax shelters worth billions.

Empty Local Jails



In 2005 a Corplan consultant pleaded guilty in federal court to paying bribes to two county commissioners in Willacy County in connection with a prison contract there. The two commissioners also pleaded guilty. Corplan wasn't charged. The next year, Parkey visited the same county to pitch another jail project. He and his team estimated the county would get $8 million within the first seven months of the contract, according to a federal suit filed against the county, Parkey, and others in 2009 by Juan Angel Guerra, then the county's district attorney. Parkey was dropped from the suit in 2010, and the case was resolved in favor of the county in 2011. "He's not a poster child," Parkey says of Guerra. "It is what it is."

Parkey is now a consultant for Emerald Correctional Management. In August, a group from Emerald visited Anahuac, Texas, to pitch Chambers County commissioners on a deportation processing center that could be used by federal authorities. The deal was to be paid for with taxable bonds. The commissioners voted no. An Emerald spokesman didn't return calls.

In September, Parkey traveled to Cleveland, Texas, almost 60 miles northwest of Anahuac, where he met with business leaders at the Lions Club, according to a report in the *Cleveland Advocate*. "Not one tax dollar of yours goes into this," he told the group.
—*Lauren Etter and Margaret Newkirk*

The bottom line The IRS is going after counties that issued tax-free bonds to build jails used by federal agencies.

[redacted]

Deficits

Lottery Winners Are Getting Stiffed in Illinois

▶ The state has racked up billions in IOUs since its budget lapsed in July

▶ "They don't get paid? That's illegal, and that's fraud"

In July, Danny Chasteen scratched off an Illinois Lottery ticket to reveal a $250,000 prize. The factory supervisor from Oglesby, about halfway between Chicago and Peoria, was delighted—until he tried to turn in the ticket and learned that lottery payouts are suspended until Democratic legislators and the state's Republican governor, former private equity investor Bruce Rauner, can agree on a budget for the current fiscal year. Chasteen, who's suing the state, joins a growing number of creditors, including state employees whose health premiums aren't being covered and private vendors who haven't seen checks since the last budget ran out on July 1. "People are spending thousands of dollars a day on lottery tickets, and they don't get paid?" says Chasteen's girlfriend, Susan Rick. "That's illegal, and that's fraud."

The pile of IOUs is worth $6 billion and growing. State Comptroller Leslie Geissler Munger estimates the total could reach $8.5 billion by yearend. The state was sued on Sept. 18 by a coalition of public employee unions, led by the American Federation of State, County, and Municipal Employees, which wants to force Illinois to resume health-care payments for 149,000 workers, retirees, and dependents. "This can't ▶

◀ continue," says Anders Lindall, a spokesman for AFSCME Council 31.

Income tax increases approved in 2011 expired at the end of last year, cutting state revenue by a projected 18 percent. Democrats are insisting on raising taxes to close the gap, while Rauner, who took office in January, says he'll consider approving tax hikes in return for reforms that would limit the bargaining power of public-employee unions. The state is running on temporary authorizations that cover some spending, but Munger has told courts that who gets paid and who doesn't is up to the legislature. So far, public schools have remained open, and state employees continue to receive paychecks. Judges have enforced a dozen court orders and consent decrees forcing the state to pay for Medicaid and social service programs, including programs for children with developmental disabilities.

Munger, whose office declined an interview request, has said she gets 5,000 phone calls a week from people looking for checks. A former marketing executive, she was appointed by Rauner in January. He tapped Munger after her Republican predecessor, Judy Baar Topinka, died of complications from a stroke, five weeks after winning reelection. In public appearances, Munger compares the challenge of rescuing Illinois's finances to her efforts to revive the Suave shampoo brand at Helene Curtis, which was bought by Unilever in 1996. (Munger left in 2001.) "We got rid of that old screw-off cap and put on a flip-top cap," she said in a Sept. 16 speech at the City Club of Chicago. "We put in a very aggressive marketing campaign. And most importantly, we took our price down." She argued the same principles apply to government. "It starts with balancing the budget," she said.

Munger, who lost a campaign for a seat in the state legislature last November, is expected to run next year to fill out her term. "She takes the old 'mad as hell and I'm not going to take it anymore' approach to the state's fiscal health," says Jim Durkin, the Republican leader of the Illinois House. Carol Portman, president of the Taxpayers' Federation of Illinois, a nonpartisan policy group, says a budget will get passed only if ordinary citizens start to feel the pain. "The public pressure isn't there," she says. —*Tim Jones*

The bottom line Illinois is entering its fourth month without a budget, and the crisis shows no sign of being resolved.

Government Spending

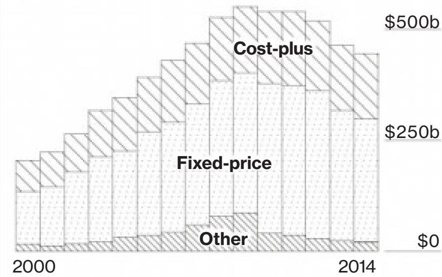
Why Washington Pays Extra for Shoddy Work

▶ **Healthcare.gov was a mess, but taxpayers still footed the bill**

▶ **"You can't buy innovation with a fixed-price contract"**

After the Obamacare website's disastrous debut, Representative Anna Eshoo, a California Democrat, demanded to know whether the Obama administration would exact a price from the contractors whose buggy software prevented millions of Americans from buying health-care policies on the federal exchange for months. "There isn't a built-in penalty, but I can tell you that paying for work that isn't complete is not something that we will do," Kathleen Sebelius, who oversaw the rollout as secretary of Health and Human Services, told Eshoo and other members of Congress at an October 2013 hearing.

Federal Contracts, 2000-14



DATA: COMPILED BY BLOOMBERG

That turned out not to be true. According to an audit released on Sept. 22, **CGI Federal**, the main contractor for the website, was paid almost all the $56 million it billed taxpayers between the failed launch of the healthcare.gov website on Oct. 1, 2013, and the following February. That included about $4 million for fixing defective CGI software that powered the insurance marketplace and connected it to other data systems needed to verify users' identities and eligibility for subsidies. The sum the government withheld for CGI's failures was $267,420—less than one day's worth of work.

Like many contractors, CGI signed what's known as a cost-plus-fixed-fee contract that passed along project costs to the government while guaranteeing the company a set fee. Under the terms of the contract, the Centers for Medicare and Medicaid Services (CMS), which oversees the federal Obamacare marketplace, had to pay CGI's costs, first for writing the defective software and then for trying to fix it. "The burden was on CMS to manage the contract, ensure that the contractor delivered the system ordered, and prevent the need for rework and defect resolution," auditors from the Health and Human Services Office of Inspector General wrote in their report. CGI claimed the problems plaguing healthcare.gov "were not the result of any failure" by the company, according to the audit. A spokeswoman declined to elaborate.

Such deals were once limited to wartime, but after World War II, the idea was codified in military procurement rules. Today the government writes cost-plus contracts for everything from U.S. Navy ships to computer

Quoted

"Russia will not succeed in imposing the military solution on Syria any more than the United States was successful in imposing a military solution on Iraq."

White House press secretary **Josh Earnest** in a Sept. 30 briefing, after Russian President Vladimir Putin ordered airstrikes in Syria

DAVID GODDARD/GETTY IMAGES

systems. There are reasons to guarantee suppliers' costs, particularly when an agency is trying to develop new systems or technology. "We're asking government agencies to buy really, really complex stuff with tremendous risk," says Trevor Brown, dean of the John Glenn College of Public Affairs at Ohio State University. "You can't buy innovation with a fixed-price contract."

In a March 2009 memorandum, President Obama directed government agencies to use cost-plus contracts only "when circumstances do not allow the agency to define its requirements sufficiently" to set a fixed price. Yet since 2009, the share of federal contract dollars flowing through cost-plus-fixed-fee contracts has increased to 18 percent from 10 percent, according to data compiled by Bloomberg.

The Navy bought the first two of its new littoral combat ships using contracts that covered the costs of shipbuilders **Lockheed Martin** and **General Dynamics**. The vessels were delivered late, over budget, and "in incomplete, deficient conditions," according to a Government Accountability Office review last year. The Navy decided to pay for the rest of the fleet with fixed-fee contracts, which are commonly used by commercial ship buyers. "They don't have nearly as much rework or defects at delivery as the Navy ships do," says Michele Mackin, a director of acquisitions and sourcing management at GAO.

In January 2014 the government hired the consulting firm **Accenture** to replace CGI Federal as the lead healthcare.gov contractor. The agency has "sought to implement extensive contracting reforms and to make needed changes," HHS spokeswoman Meaghan Smith said in an e-mail. Accenture's contract is structured to link payment more closely to performance, and it's monitored in weekly and monthly meetings with CMS. "We have already put in place a number of reforms to limit costs and to ensure accountability for our progress," Smith says. But, she adds, "we are always looking for ways to further improve our contracting systems."
—John Tozzi, with Brian Friel

The bottom line Taxpayers paid the contractor responsible for the faulty Obamacare website $4 million to correct the problems.

Edited by Allison Hoffman
Bloomberg.com

Hidden Hand

Frank Kendall

Under secretary of defense for acquisition, technology and logistics

Within a few weeks, the Air Force may choose which company will build the next generation of long-range bombers to replace aging B-52 and B-1B planes. The program could cost $80 billion for 100 aircraft. Bidding for the contract pits Northrop Grumman against a Lockheed Martin-Boeing partnership. No decision will be made without a green light from Frank Kendall, the Pentagon's top weapons buyer. ▶ Kendall, an aeronautical engineer with an MBA, has overseen $1.8 trillion in unclassified contract awards since returning to the Pentagon in 2010 after a 16-year break. He issues defense acquisition memoranda that trigger final decisions on major contracts. He can also send proposals back to the drawing board—or to the waste bin. In the case of the new bomber, he says, "I know that we have viable bids." ▶ Air Force officials originally suggested the choice would be made by the end of the summer. Congressional Republicans have responded to the delay by cutting $460 million from the $1.3 billion the Pentagon requested for the program in 2016. "There are a lot of things you can't control," Kendall says. "You can't control your budget. You can't control the competency of contractors." And, he adds, you can't control "the unknown unknowns that pop up."
—Tony Capaccio

Curriculum vitae

2012-present
Under secretary of defense

2010-12
Deputy under secretary of defense

2008-10
Managing partner, Renaissance Strategic Advisors

1997-2009
Consultant-attorney

1994-96
Vice president for engineering, Raytheon

1994
Vice president, SAIC

1986-94
Various positions, Office of the Secretary of Defense

1982-86
Analyst, U.S. Army Ballistic Missile Defense Systems Command

1967-82
Active duty, U.S. Army

Education
J.D., Georgetown University Law Center, 2004
MBA, Long Island University, 1980
M.S., CalTech, 1972
B.S., U.S. Military Academy, West Point, 1971

Charlie Rose talks to...

Lisa Monaco

Obama's security and counterterrorism adviser discusses battling Islamic State and its high-tech propaganda machine

JONATHAN ERNST/REUTERS

Vladimir Putin told me he'd rather fight Islamic State in Syria than back home, but he clearly still supports Assad. How do you respond to that?
The Assad government and what it has done to its people through the use of barrel bombs and other atrocities is a magnet for extremists. And indeed, foreign fighters flow into Syria. Assad is not a counterterrorism partner. He's not going against ISIL. If the Russians want to make some constructive contributions to the fight against ISIL, that's a good thing. I would say, however, there's no need to reinvent the wheel. The president began—and continues to lead—a coalition of 60-some-odd nations countering ISIL.

How is Islamic State different from what we've come up against in the past?
It's a threat different in kind from al-Qaeda and its affiliates. They've displayed an almost apocalyptic ambition, certainly a brutality that's been unprecedented. They've shown the ability to take and hold territory. ISIL's also different in its vision of a caliphate, but the most distinguishing feature is the success and ability with social media. A few years ago, my colleagues and I were focused on al-Qaeda in the Arabian Peninsula's use of a magazine to reach followers. That looks like the eight-track version of propaganda now.

Are social media used mainly for recruiting?
People use the term recruiting, but it's more like enlistment, because they put the messages out there. There are some 90,000 Twitter accounts that are associated with ISIL and are sympathetic to it. A smaller number of those may be real, true ISIL members. But they themselves will have 50,000 followers at a shot, so just do the math. It's a brutal irony, when you think about it. ISIL is a group that's dedicated to rejecting modernity. And what they use is one of the greatest innovations that the U.S. has brought to the world.

And countering this sort of propaganda falls to the State Department?
The State Department runs, under the leadership of Rick Stengel, something called the CSCC, which is basically a strategic communications center to provide messaging that seeks to counter ISIL's narrative. Rick's doing a tremendous job on that, and he's worked to set up the Gulf version of this in the UAE. But what really needs to happen is we have to lift up the voices of those people who have traveled and found that ISIL is being hypocritical. It can't govern. It's not a romantic jihad. It's a savage undertaking where women are enslaved and raped and beaten.

"They've displayed an almost apocalyptic ambition, certainly a brutality that's been unprecedented"

What happened with the moderates in Syria we planned to train and equip?
It's very difficult to build up, in essence, an infantry among people who are worried about their families, fighting for their lives, figuring out how to sustain themselves, even as they wonder whether or not to stay in Syria. In the cauldron of extremists and those trying to fight the regime and ISIL, it's a very difficult challenge to vet these individuals, to make sure they can be trained, that they can be trusted. That's the effort we're undertaking with coalition partners, with Turkey, with Saudi Arabia, with Jordan.

Tell me about the successes you've had against Islamic State's leadership.
We've been putting a tremendous amount of pressure on ISIL in Iraq and increasingly in Syria. Abu Sayyaf, who was a key finance leader, was killed during the course of a capture operation. In that raid a tremendous amount of intelligence was gathered, and that helps us understand what ISIL is doing with its finances. Also in Iraq, during coalition operations, the U.S. military was able to remove from the battlefield Haji Mutazz, the No. 2 in ISIL.

What's an example of their success with social media?
There are several examples of those who are in contact with ISIL here in the U.S. In fact, the FBI has made about 50 arrests in the last year of individuals who are either in contact with ISIL or they're inspired by and seeking to travel and lend their support to ISIL. Some 30 percent of them are under the age of 21.

Block This

▶ Flush with ad revenue, Facebook readies new tracking tools

▶ "Biggest question we get...is, 'Why aren't ads more relevant?'"

For the ad industry, the lead-up to this year's Advertising Week conference in New York has been a little more exciting than usual, and not in a good way. Apps designed to block mobile browser ads have been topping the charts on **Apple**'s App Store, and the industry continues to struggle to guarantee that the remaining views come from real people instead of software bots. Fake traffic will cost advertisers $6.3 billion this year, according to a study by anti-fraud firm White Ops. It's becoming less clear whether online ad networks really deliver on their promises to give advertisers unprecedented control over who sees a campaign and detailed pictures of how well an ad works.

Facebook doesn't have that problem. In part because of new features that track and measure more of its 1.5 billion users' behavior in more places, the social network's second-quarter ad revenue jumped 43 percent this year, to $3.8 billion. About three-quarters of the revenue now comes from mobile devices, and if you're using the Facebook app instead of a Web browser, those ad-blocking browser tools don't stop anything. Count the viewers, Chief Operating Officer Sheryl Sandberg said on Sept. 29 during an onstage interview at Ad Week: "We have a Super Bowl on mobile every day."

The world's largest social network is taking advantage of a change it began making a year ago, shifting its tracking focus from browser cookies to Facebook logins. The idea is to improve ad targeting by associating views with a person's account instead of a particular device or IP address. This has helped Facebook ensure that advertisers who buy views from specific age groups or genders actually reach the people they want to 89 percent of the time, according to Facebook. Across Internet ad networks, the average is about 55 percent.

On Sept. 15, Facebook said that in October it would begin using the "like" and "share" buttons nestled in most of the Internet's popular websites to more narrowly target ads based on a person's browsing history. That tracking ability doesn't even require someone to click "like" or "share," according to Facebook, because the buttons passively watch and record browsing behavior.

Facebook's changes have helped make its ads almost as attractive as the ones next to search results, says Chris Tuff, an executive vice president at ad agency 22Squared. "If you put all the social networks next to one another from least evolved to most evolved, Facebook is ahead of them all," he says. The changes have also exacerbated concerns about how closely the company monitors its users, says Marc Rotenberg, president and executive director of the Electronic Privacy Information Center. "It is more intrusive," says Rotenberg. "And of course the user did not agree to this."

Between sips of strawberry water at Facebook's Menlo Park (Calif.) headquarters a few days before Ad Week began on Sept. 28, Sandberg said her 2.5 million advertisers always crave more information about their audience, but they're wary of annoying people who are trying to scroll through wedding announcements or vacation photos. "They want to take the opportunity to reach people in a way that feels good, that's not intrusive," she said.

Working in Facebook's favor: People have had years to get used to the ads that resemble friends' news feed posts. Just as important, Facebook has maintained an emphasis on a single account tied to a person's real-world identity, even as the company has swallowed other ▶

ILLUSTRATION BY 731

◀ popular services like Instagram and WhatsApp. That makes each user more valuable to advertisers. It also makes people easier to follow from PC to smartphone to tablet and back.

Facebook weathered privacy complaints for years as it quietly pushed more of its users' actions and interactions into the public sphere. At this point, according to Sandberg, "The biggest question we get–literally, by far–is, 'Why aren't ads more relevant?' " Eventually, Facebook seeks to link the ads across its services, says Carolyn Everson, the company's head of revenue.

First up is Instagram. Companies that advertise on the photo-sharing service will be able to target users based on Facebook demographic data. "It's possible we could start an advertiser's story on Facebook, know if that person's on Instagram, and tell a sequential story to build on that story, or vice versa," Everson says. LiveRail, the Facebook-owned video ad network used by more than 200 companies, including **Major League Baseball** and **CBS**, is now using age and gender data from Facebook, too.

To some extent, Facebook relies on users reporting whether they found an ad helpful, and that kind of quality control is part of what's shielded the company from the problems plaguing other online ad giants, says Brian Blau, an analyst at researcher Gartner. That will get tougher as Facebook takes steps to expand its empire to other apps and websites, which could open it up to more fake ad views. "They're definitely going to be more susceptible to general abuse and click fraudsters," Blau says. "The bigger they get, the harder it gets to rely on users to tell them something is bad."

76%

The share of Facebook's revenue that comes from mobile advertising

Facebook advertisers accustomed to buying TV spots will soon have new software for video ad buys based on desired numbers of "ratings points," which Facebook is partnering with Nielsen to ladle out. Facebook is also experimenting with letting brands poll smartphone users for feedback directly through Facebook and Instagram. These tactics sound a little antiquated compared with Facebook's tracking and data-analysis tools, but they're in keeping with Everson's push for increasingly personalized ads. She says someone who's bought a car recently should stop seeing ads for new cars and start seeing suggestions from the automaker about how to use the features in her own vehicle. "Otherwise," she says, "it's just a waste." *—Sarah Frier and Joshua Brustein*

The bottom line Facebook is pitching its 2.5 million advertisers new tracking tools while it largely evades ad blockers.

Hardware

Google Is Acting More Like a Phone Maker

▶ **Its new models target a wider range of customers**

▶ **Nexus is "what we think this experience should look like"**

Since 2010, **Google** has been co-producing its Nexus line of high-end phones with Android partners such as **HTC**, **Samsung**, **Motorola**, and **LG**, sold alongside those companies' own models. Google knows its own operating system best, the thinking goes, so who better to design the mobile hardware to show off what the software can do? For the most part, though, Nexus products have been more popular with reviewers than with the general public. While Google doesn't disclose Nexus sales figures, the company has acknowledged disappointment with sales for 2014's smartphone, the Nexus 6.

This year, Google is doubling down on Nexus. On Sept. 29 it unveiled two smartphone designs, the Nexus 6P and 5X, updated versions of its previous two models. It's the first time Google has released two Nexus phones at once, and they represent a more serious effort to broaden the market share of Google-designed hardware. While Nexus phones have typically been used to showcase Android features that might be useful a year or two later, such as wireless charging or ultrahigh-definition video recording, the new editions are built to compete more directly with high-end iPhones and midmarket rivals in the current market.

"With these two phones, Nexus now sits in the midrange and in the premium parts of the market," says Venkat Rapaka, Google's director of product management for Nexus. "In the past we never built more than one phone, so we had to serve one kind of audience."

The 6P is the first Nexus device made by China's **Huawei Technologies**, replacing Nexus 6 manufacturer Motorola. Its aluminum, single-piece construction, fingerprint sensor, and reversible USB-C port add a hint of futurism without making it a geeks-only phone. Last year's 6-inch model was criticized for being a little too big and expensive–$650 without a wireless contract. The 6P's speed, camera quality, and price clearly target higher-end buyers, but it's a little smaller, at 5.7 inches, and cheaper, at $500 for the version with 32 gigabytes of storage space.

The Nexus 5X, made by LG, is a more modest design, with a $380 starting price. It has a 5.2-inch screen and a slower processor, and it doesn't have the metallic sheen of its big brother. It does have the fingerprint sensor, high-end camera, and USB-C port of the deluxe version, though, and it's half the price of **Apple**'s new iPhone 6S, with some comparable specs.

With both Nexus phones, Google's biggest competition may not be Apple, but its own Android partners, says James McQuivey, an analyst at Forrester Research. "Today people are getting access to plenty of the best benefits of Android without having to buy a Nexus phone," he says. "I think Samsung has clearly demonstrated that it doesn't need any prompting from Google to push on the Android ecosystem."

Although a more diverse Nexus line may heighten the competition among Google's phones and other Android models, Rapaka says the company isn't worried about coexisting with its partners. "Nexus is the purest distillation of what we think this experience should look like," he says. "We also want there to be a choice that comes straight from the team that built Android." For now, Google has

Head to Head

Nexus 6P Android 6 Marshmallow	**iPhone 6S Plus** iOS 9
2.0GHz octa-core Snapdragon 810 processor	1.84GHz dual-core Apple A9 processor
3GB of RAM	2GB of RAM
12.3MP main camera	12MP main camera
8MP front camera	5MP front camera
5.7-inch display	5.5-inch diagonal display

CLOCKWISE FROM TOP: SAN FRANCISCO CHRONICLE/POLARIS (2); STEELBLUE (1)

restricted the 6P and 5X rollouts to the U.S., the U.K., Ireland, and Japan.

Google might be better served aiming for the extreme high end, says McQuivey. “I would think of retiring the concept of making flagship devices, unless you go the way of concept cars in the auto market, purely as a way to say this is what a phone is capable of,” he says. “If Google really wants to accomplish the concept car model, then they should really push the envelope.” —*Stephen Pulvirent*

The bottom line Google’s expanded Nexus line remains high-end but is cheap enough to compete with many of its Android partners.

Office Space

Silicon Valley Leaps Across the Bay

▶ Developers are remodeling Oakland offices to resemble San Francisco’s

▶ “Oakland has changed quite suddenly in the past six months”

A Unicorn Comes to Oakland

2014

2015

2017

330,000 square feet of office space earmarked for 2,000 Uber employees

This Beaux Arts-style building in Oakland, once owned by Sears and soon to be occupied by Uber, dates to 1929. The new plan includes perks such as an organic food court. Offices in Oakland rent for about $40 a square foot per year, compared with $60 across the Bay Bridge.

The Northern California counties across the Bay Bridge from San Francisco have missed out on much of the technology boom. In 2014 tech employment grew 21 percent in San Francisco, to 59,000 jobs, and 4 percent, to 50,000 jobs, for all of neighboring Contra Costa County and Alameda County, which includes Oakland. With San Francisco apartment rents averaging more than $3,000 a month, 40 percent higher than in the East Bay, about half of Alameda residents leave to commute to work. Most of those cross the Bay to get to their tech jobs. Highways, bridges, trains, and ferries are nearing capacity.

“We have overrun the infrastructure,” says Carl Bass, chief executive officer at design software maker **Autodesk**, which has 8,000 employees spread across several Bay Area offices. “With San Francisco becoming supercrowded and superexpensive, Oakland is now a real alternative.”

Developers have begun transforming the city of Bobby Seale and the Symbionese Liberation Army, a place still rocked from time to time by brick-flying protests against cops and corporations, into what they hope will become a hub for tech companies. To lure hipster tenants to downtown Oakland, landlords are remodeling old department stores and office buildings into open-plan spaces full of exposed brick and timber.

Oakland has 4.4 million square feet of what brokers call creative space, says developer **Jones Lang LaSalle**, with 10.1 percent standing empty. Those offices rent for about $40 a square foot per year, compared with roughly $60 a square foot in San Francisco.

“I really can’t think of a better place to be,” says Tamir Scheinok, co-founder and chief operating officer of **Fluid**, a company that designs e-commerce websites for the likes of North Face and Reebok. “It’s really important for us to be in an enriching environment with bars and restaurants and a diverse community,” he says. Scheinok is moving his 100 or so employees from San Francisco to Oakland in November. As a result, Fluid’s rent will rise by about a third instead of doubling, he says.

Some half-dozen tech companies are moving to or expanding in Oakland this year, including Web design company **99Designs**, online ad agency **Huge**, and philanthropic incubator **Emerson Collective**, headed by Laurene Powell Jobs, Steve’s widow. Besides the ecosystem of bars and restaurants that’s grown with the remodeled office space, downtown Oakland’s appeal is strengthened by its proximity to many of the city’s most attractive residential neighborhoods, employers say. “People worried Oakland was a liability for recruiting,” says Tim Westergren, co-founder of streaming music service **Pandora Media**, which has been based in the city since shortly after its founding, in 2000. “Now we’re finding it’s a plus.”

Lane Partners, a Silicon Valley-based developer of tech office parks, has rechristened Oakland’s old Sears building Uptown Station, replete with a ground-floor food court that specializes in locally grown organic tayberries and stuffed squash blossoms. **Uber** bought the seven-story building last month and says it’s prepping the 330,000 square feet of office space for about 2,000 employees beginning in 2017.

Brokers and the local press regularly float rumors that other tech giants, ▶

including **Intel**, **Microsoft**, and **Google**, are checking out Oakland real estate. Google declined to comment; Intel and Microsoft didn't return calls. Bass says Autodesk looks at Oakland buildings "all the time" in search of space for 300 to 500 workers. "We hire people at $80,000 to $100,000 a year who have to use much of their income to live in San Francisco," he says.

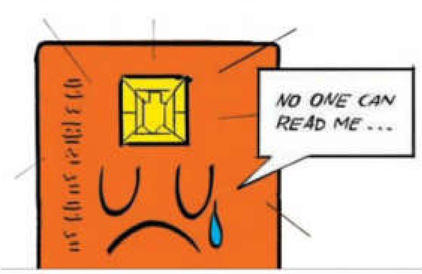
Oakland officials are talking to developers about building a 140-acre neighborhood between downtown and the city's airport. Coliseum City, as the proposal is called, would include a 750,000-square-foot technology park, 3,500 housing units, 380,000 square feet of retail, and as many as three sports stadiums, a point of controversy.

Whether or not Coliseum City becomes a reality, Oakland will remain far from the "absolute ghost town" that Fluid's Scheinok, who's lived in the city on and off since 1988, says he remembers. "Oakland has changed quite suddenly in the past six months," he says. "It's now an intersection of culture and commerce." —*Peter Waldman*

The bottom line With Oakland office space a third cheaper than San Francisco's, landlords are preparing for a tech influx.

Cybersecurity

Credit and Debit Cards Lag on Upgrades



▶ Half of Americans won't get a chip-loaded card by the deadline

▶ "Moving to new payment devices didn't justify the cost"

In early 2014, shortly after 40 million **Target** customers may have had their credit or debit card data exposed by hackers amid a slew of similar cybercrimes, the retailer's executives told the U.S. Senate Committee on the Judiciary that changes were coming. Among them, the executives said: Once banks issued American customers the chip-loaded cards Europe's been using since the 1990s and stores retrofitted their checkout counters to work with the technology, crooks would have a tougher time stealing useful data. A couple of years earlier, card networks like **Visa** and **MasterCard** had set a deadline for most companies of Oct. 1, 2015.

The deadline's passed, and only half of Americans have a chip-equipped card. Fewer than half of banks and credit unions have adopted chips, and barely one-quarter of retailers have, according to researcher Crone Consulting. "It's going at a snail's pace," says Chief Executive Officer Richard Crone. The card companies say they'll likely need at least two more years for the transition from old-school magnetic stripes and that the Oct. 1 target wasn't meant to be firm. "It's not a deadline; it's more of a start line," says Stephanie Ericksen, a vice president at Visa.

Chip technology is more secure than magnetic stripes because the chips generate new authentication codes for each transaction, while the codes built into magnetic stripes are permanent and can be copied and stored by hackers for later use. Chip cards cost banks as much as $2 apiece, 5 to 10 times what the old ones do. For now, many of the cards banks are sending out have both stripes and chips, because most U.S. checkout counters haven't switched over yet. "It is a little bit of a chicken-and-egg thing," says Vinnie Brennan, head of card services for payment processor **Fiserv**. "The merchants say, 'We don't want to upgrade, because there aren't that many cards in the market.' The financial institutions say, 'There's not enough equipment in the market.' "

When the card companies set the deadline, they told merchants to expect to shoulder the costs of fraud if they didn't make the switch. Target and **Wal-Mart Stores** have spent millions to outfit registers with chip readers that can cost $600 to $2,000 apiece. For most merchants, though, "It makes no sense," says Greg Buzek, president of researcher IHL Group. That's because, he says, most stores' fraud losses are small. "We looked at the numbers and decided that moving to new payment devices didn't justify the cost," says Caleb Mitsvotai, senior manager for innovation and technology at **Panda Restaurant Group**, which oversees 1,800 U.S. restaurants.

Chip-reader adoption lags especially among small businesses, of which only 42 percent plan to make the switch, according to a survey published in June by software maker Intuit. Partly, that's because more security means less convenience, says Buzek. For the chips to work, cards have to stay inserted in a payment terminal throughout the transaction, and merchants worry that they could slow checkout and hurt sales, especially around the holidays.

Some merchants are installing chip-capable terminals less for security than because the hardware makes it easier for customers to use loyalty program apps, says Crone. **Walgreens** switched in 2012 to get its program going, and Mitsvotai says Panda's will eventually justify a hardware upgrade.

About 60 percent of U.S. cards and 40 percent of checkout counters will be chip-enabled by Jan. 1, according to the Payments Security Task Force, an industry group that includes Visa and MasterCard. Javelin Strategy & Research predicts that fraud at U.S. cash registers will decline from $6 billion last year to $5 billion in 2018 as chips become more prevalent. Ultimately, wider adoption may be the biggest motivator for holdouts to upgrade their own systems, says Bob Legters, a senior vice president at banking IT company FIS. "If you are the last guy in the neighborhood without bars on your windows," he says, "you are going to get robbed." —*Olga Kharif and Elizabeth Dexheimer*

The bottom line Banks and retailers have been slow to spend money on chips and chip readers for credit and debit cards.

Biotech

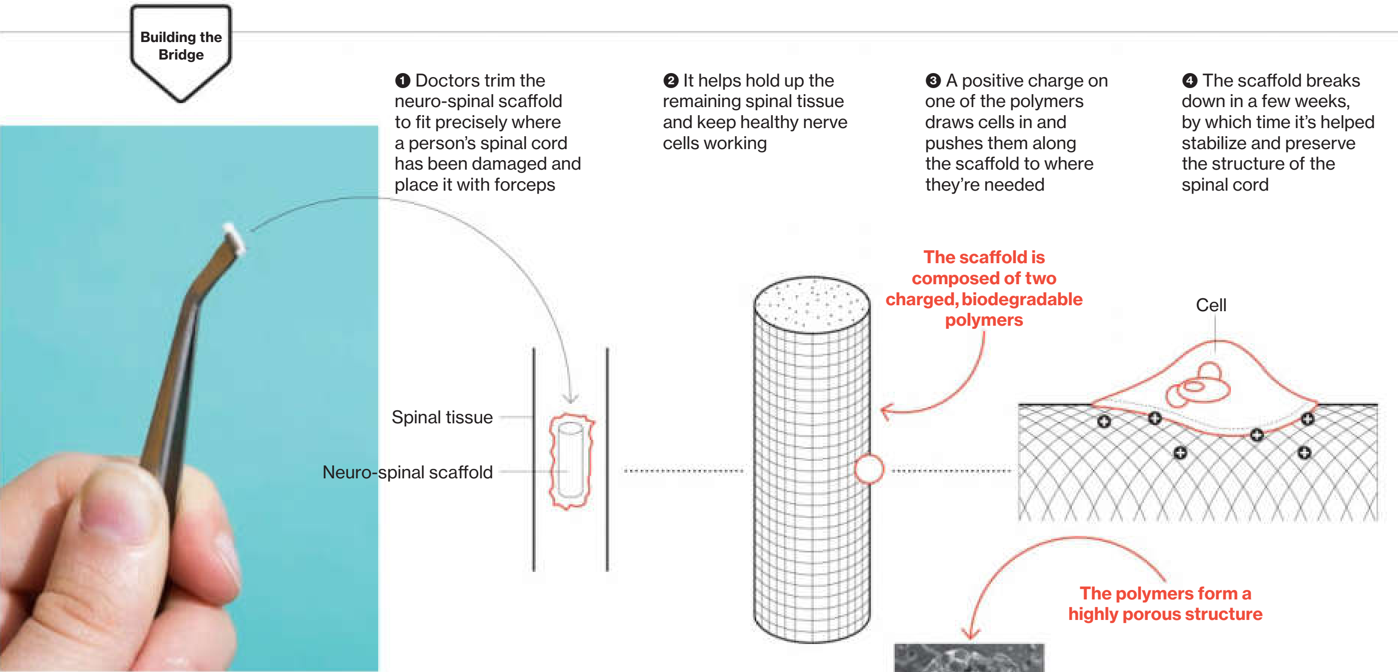
Early Promise for a New Paralysis Treatment

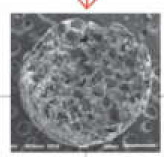
▶ Startup InVivo treats nerve cells within the spinal cord

▶ "If we can preserve those cells, maybe we'll get some function back"

Four months ago, Roger, a 55-year-old construction worker from Mooresville, N.C., fell out of a deer stand and was left with a damaged spinal cord and no sensation from the middle of his chest down. Patients with his condition typically have less than a 1-in-20 chance of recovering any feeling in or control

FROM LEFT: ILLUSTRATION BY 731; PHOTOGRAPH BY 731; ILLUSTRATIONS BY 731; COURTESY INVIVO





over the paralyzed areas. A new kind of implant aims to change that.

At Carolinas Medical Center in Charlotte, Roger, who doesn't want to disclose his last name to protect his privacy, allowed doctors to perform an experimental procedure that involved cutting directly into his spinal cord to insert a sort of bridge for surviving nerve cells. Within a month, he regained feeling in his abdomen, some feeling in his legs, and some bladder control. While he's not walking, he says he's determined to get there and is getting leg braces so he can move with a walker.

Roger was the third patient to receive the implant, made by **InVivo Therapeutics** in Cambridge, Mass., and the second with markedly improved bodily function. The chance of that happening was below 1 percent, according to InVivo Chief Executive Officer Mark Perrin, and it's welcome news for the 8,000 Americans who suffer spinal cord-related paralysis each year.

Conventional treatment focuses on repairing a fractured spine with rods and screws, but it doesn't address the spinal cord itself, which relays electrical impulses from the brain to the body. Imaging studies show that cell death in the spinal cord generally spreads even as patients recover. InVivo's device, called the neuro-spinal scaffold, is a tiny cylindrical implant made of biodegradable plastic fibers. It supports nerve cells like a trellis, directing their growth where needed.

"You're not just trying to stabilize the spine, but do something helpful directly at the area of the injury," says Dom Coric, chief of neurosurgery at Carolinas Medical Center, who's working with InVivo. "If we can preserve those cells, maybe we'll get some function back." The implant dissolves over several weeks, he says.

InVivo's scaffold emerged from the MIT lab of Bob Langer, a biomedical engineering professor who's founded some two dozen companies. More than a decade ago, Erin Lavik created a prototype scaffold for her MIT graduate thesis. As detailed in a breakthrough study she published with Langer in 2002, Lavik's device, seeded with stem cells, helped paralyzed rats walk again. Later tests on rodents and monkeys proved similarly encouraging. (So far, human tests haven't included stem cells.) Lavik is now a biomedical engineering professor at Case Western Reserve University.

InVivo, co-founded by Langer in 2005, licensed the technology from MIT in 2007 to commercialize it. The U.S. Food and Drug Administration initially granted the company permission to treat five patients, tracking each for three months before enrolling another. In October 2014, Jordan Fallis received the implant after a flip on a dirt bike paralyzed him from the waist down, and he regained some motor function. Patient No. 2, Jesi Stracham, has regained some sensation but no motor function in her legs since her motorcycle accident. Following those results, the FDA allowed InVivo to simultaneously enroll its last three patients, including Roger.

Langer, who's been closely watching the patients' progress, says he expects even better results when the company seeds the scaffold with stem cells or other growth factors to encourage regrowth of damaged nerves. InVivo has received a humanitarian device exemption, meaning it needs only proof of "probable benefit" to get FDA approval for wider use, according to CEO Perrin. He says he's still talking with the FDA about what further tests the agency might want and wouldn't set a target date for commercial approval.

While InVivo negotiates with the FDA, other scientists are working on new materials that could further stimulate cell growth within the spinal cord. Anthony Windebank, a neurologist at the Mayo Clinic's Regenerative Neurobiology Laboratory, is working to develop biodegradable polymers that mimic the jello-like properties of the spinal cord. "The technology is changing, and what we can do with cells and biomaterial is revolutionary," he says. It would be immoral, he says, "to not pursue this as hard as we can." —*Michelle Fay Cortez*

The bottom line InVivo's neuro-spinal scaffold has led to marked improvement in two of its first three patients. FDA approval is pending.

Edited by Jeff Muskus
Bloomberg.com

PHOTO ILLUSTRATION BY

▶ Crashing prices are upending copper and aluminum players

▶ When China catches a cold, "base metals catch pneumonia"

These are tough times to be in the commodity business. A selloff in the oil market that began in June 2014 has extended to a range of raw materials and is starting to resemble a full-blown meltdown. Investors reacting to weaker Chinese demand and an end to cheap money provided by the Federal Reserve are rushing to sell positions in companies that produce, trade, and ship everything from oil to gold to copper and aluminum. A Bloomberg commodities index that tracks returns from 22 raw materials has fallen 50 percent since a 2011 high and is trading near its lowest level since 1999. Of the 10 worst performers in the Standard & Poor's 500-stock index this year, eight are commodities-related companies.

Monday, Sept. 28, was particularly tumultuous. In the span of a few hours, **Alcoa**, a 127-year-old industrial bellwether and the largest U.S. aluminum producer, announced it would break into two smaller companies, while **Royal Dutch Shell**, one of the world's top oil producers, said it was abandoning its drilling campaign in U.S. Arctic waters after spending $7 billion. The carnage culminated when shares of **Glencore**– the Swiss commodities powerhouse that trades and produces some of the world's most critical raw materials, including zinc and copper–lost nearly a third of their value.

"Fears in the market have intensified," says Ed Hirs, who is managing director of small oil producer Hillhouse Resources and teaches energy economics at the University of Houston. "Lower demand for all commodities seems to have sent everybody off the cliff."

This may only be the beginning. Analysts John LaForge and Warren Pies of Ned Davis Research Group, based in Venice, Fla., say commodities are in the fourth year of a 20-year "bear supercycle." The analysts looked at commodity busts dating to the 18th century and found they're typically driven by market momentum more than supply and demand fundamentals. "In commodities, you're going to get a lot of failures, companies closing up," LaForge says. "This needs to happen to bring down supply." The good news: Most of the damage is done in the first six years.

In a way, commodity producers are ▶

simply reaping what they've sown. A decade of high prices, driven by rising Chinese demand, induced billions of dollars in new investments aimed at boosting production. Copper miners alone increased their combined annual capital spending to expand operations fifteenfold, to more than $33 billion from 2002 to 2012, according to Citigroup. Now, just as all that new metal is being dug out of the ground, demand for it is slowing, leaving entire industries awash in raw materials.

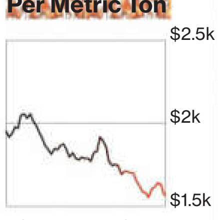
Not only is China on pace for its worst annual growth in 25 years but the way its leaders plan to transition the economy from industrial-intensive growth to more consumer-oriented activity is also particularly troublesome for metals companies that supply its factories. The mainland remains the world's leading metals consumer, so even the slightest dip in demand produces ripple effects. "When the Chinese economy catches a cold, base metals catch pneumonia," says Tai Wong, director of commodity products trading at BMO Capital Markets.

China consumed nearly half the world's copper in 2014, according to Goldman Sachs. Its demand should stay flat this year, the firm says. If so, this will be first time since 1988 that demand for copper in China didn't rise, according to Goldman. Even as producers slash output, the world will be stuck with a surplus of 485,000 tons of copper, 18 percent more than last year. As a result, Goldman expects copper prices in 2015 to average about $5,670 a ton, 17 percent lower than in 2014.

To show how important China is to the global copper industry, Dane Davis, an analyst at Barclays, points to the country's construction industry, which consumes about as much copper (3 million to 4 million tons a year) as the entire economies of Canada, Japan, Mexico, and the U.S. combined. "It's quite incredible," he says. That poses a significant problem for mining companies as the Chinese real estate market cools and infrastructure spending flattens. A more consumer-driven China will need plenty of energy- and food-related commodities to meet the needs of a population trying to raise its living standards. Metals are a different story. "The consumer economy is far less metals-intensive on a per-capita basis," Davis says.

Copper Price Per Metric Ton

Aluminum Price Per Metric Ton



This has consequences for Glencore, which rode the commodities boom better than any other company but is now getting crushed by the bust. Since April, Glencore shares are down 71 percent. Derivatives traders have started demanding upfront payments to protect against a default by the company, the first time that's happened since credit markets were thawing in 2009.

Investors weren't reassured by a $10 billion debt-reduction plan announced three weeks ago by Ivan Glasenberg, Glencore chief executive officer, as well as a plan to sell its agricultural unit. Amid the stock rout on Sept. 28, Investec, a U.K.-based investment bank, warned that if low commodity prices persist, there would be little value left for Glencore's equity shareholders. "People smell blood, and they are circling," says Clive Burstow, who helps manage $44 billion at Baring Asset Management in London. "The market is looking for someone to test, and Glencore is in the sights."

A year after a 2011 initial public offering valued Glencore at $59 billion, Glasenberg executed what's now seen as a disastrous move to buy Xstrata, then the world's biggest coal exporter, for $29 billion. The idea was to give Glencore's traders access to abundant and diverse supplies of raw materials from mines Xstrata owned. Ironically, that broad exposure is at the heart of the company's problems now. "Glencore is no longer just a trading house. It owns significant copper assets, so lower prices will definitely hurt its revenue stream," says Mu Li, director of base and specialty metals research at CPM Group.

On Sept. 29, Glencore said in a statement that its business is "operationally and financially robust" and that it has "absolutely no solvency issues." By the end of trading in London on Sept. 30, Glencore shares had rallied and recouped most of their losses from Monday's crash.

Like Glencore's troubles, Alcoa's stem from China. Rather than shutter factories that turn an ore called bauxite into aluminum and risk extensive job losses, the country has kept the plants running and is churning out record amounts of low-cost aluminum, driving down prices. About half of all global aluminum production is losing money at current prices, the most since the financial crisis of 2008, according to Macquarie Group. Last year, China accounted for 52 percent of global aluminum production; this year it will produce 30.5 million metric tons, or nearly 3 million tons more than last year, according to analysts at Morgan Stanley.

Rather than compete with that cheap supply, Alcoa is splitting off its shrinking smelting operation to focus on its higher-margin business of manufacturing aluminum products for the transportation, construction, and aerospace industries. And that may mean it will end up buying aluminum made in China. *—Joe Deaux, Bradley Olson, Sonja Elmquist, and Jesse Riseborough*

The bottom line The crisis in the metals market has Alcoa splitting off its smelting business and Glencore is scrambling.

Real Estate

Indian Casino Bets Pay Off for Och-Ziff

- The hedge fund offers expensive loans to tribes with limited options
- "They came to our tribe when nobody else would"

After struggling for more than a decade to secure land and financing, the Jena Band of Choctaw Indians was finally able to build its $30 million Pines Casino in Dry Prong, La., thanks to a high-priced loan from **Och-Ziff Capital Management**. More than half of the casino's profits go to Och-Ziff, the $46 billion hedge fund company run by ex-Goldman Sachs trader Daniel Och. After other creditors get their portion, the tribe is left with less than 10 percent of the take. Cheryl Smith, who has been chief of the Jena Band for 11 years, isn't complaining about the terms of the deal. "They came to our tribe when nobody else would and took a chance on us," she says. "With the little money we have gotten so far, we have done good things."

Over the past eight years, Och-Ziff has become one of the largest nonbank financiers to tribes, backing casinos and hotels in Oklahoma, Ohio, and

$29b

Larger than the GDP of Zambia

Revenue of Indian casinos in 2014

California, as well as Louisiana. It also owns thousands of slot machines it leases to casino operators. Casino investments have helped one of the company's real estate funds produce returns of almost 23 percent annually from 2011 through June 2015, according to regulatory filings. About $250 million, a fifth of its invested real estate capital, is in tribal gaming. "We looked around at commercial real estate in 2006 and 2007 and saw it was overvalued," says Steve Orbuch, head of Och-Ziff's real estate group. "What we liked about tribal gaming was that it was a large marketplace with $25 billion a year in revenue, and yet it wasn't open for lending from traditional sources."

Och-Ziff's most valuable tribal relationship is with the 60,000-member Chickasaw Nation. The WinStar World Casino and Resort in Thackerville, Okla., is the Chickasaws' crown jewel. The largest casino in the world by number of gaming positions, it has about 7,500 slot machines and entertains 3.6 million visitors a year. The hedge fund helped finance the casino's expansion in 2007, making a name for itself as a funding source for tribes that couldn't get traditional loans. While Orbuch and Chickasaw officials declined to discuss specifics of their arrangement, bankers, consultants, and other tribes provided details of how nonbank lenders, including Och-Ziff, operate.

Och-Ziff offers loans with annual rates as high as 15 percent to be paid back in about five to seven years, according to people familiar with the deal. Since investors can't by law share in the equity of the businesses on tribal land or use buildings on reservations as collateral for debt, their only claims are to the revenue generated from gaming or other businesses.

About 40 percent of the recognized tribes have gaming operations, according to the National Indian Gaming Commission. Their revenues reached $29 billion last year, up from $121 million in 1988, the year Congress passed a law regulating gambling on Indian land. Yet Och-Ziff's gaming profits may be tough to sustain in the face of competition from other lenders, including some tribes, and a glut of casinos in some parts of the country. A federal investigation centering on whether Och-Ziff's dealings with a Libyan sovereign wealth fund violated the Foreign Corrupt Practices Act could crimp the firm's off-reservation gambling ambitions if the probe leads to legal action, according to half a dozen lawyers who specialize in gaming law. A spokesman for Och-Ziff, which disclosed the inquiry in a filing last year, declined to comment.

Some lenders have been burned. The giant Foxwoods Resort Casino in Connecticut, run by the Mashantucket Pequot Tribal Nation, defaulted on more than $2 billion of bonds in 2009 and spent almost four years restructuring its debt. Because U.S. bankruptcy law doesn't apply to sovereign nations, there was no bankruptcy judge to help streamline the negotiations. In February, Fitch Ratings said the tribe may be forced to restructure its debt again.

—Heather Perlberg and Katherine Burton

The bottom line Indian casino investments helped an Och-Ziff fund return almost 23 percent from 2011 through June 2015.

Fraud

Investment Schemes Lure China's Pensioners

▶ Private companies target elderly investors looking for high returns

▶ "My experience is, don't stick with any company for too long"

Unable to get bank loans to fund cash-thirsty projects such as oil pipelines and shopping malls, little-known Chinese private investment companies are popping up, promising returns of 10 percent or better and luring elderly pensioners with free lunches and shows. Acting as either middlemen or direct investors in risky development projects, the companies distribute fliers that typically list several offers with returns in the low double digits. Potential investors who respond are offered higher rates for even riskier deals while enjoying a free meal.

A recent feast of radish soup, spare ribs, red-cooked pork, fried vegetables, and a yogurt cup at a downtown Beijing restaurant drew about 100 mostly elderly people to a lecture on the importance of investing. Attendees were treated to a magic show featuring a severed hand, a bamboo flute concert, and a whirling acrobat–as well as a promise of 12 percent annual returns if they'd invest in a real estate project in Chengdu.

That's low compared with other investments being pitched to Beijing's elderly. One recent vehicle, to fund the purchase of a small oil pipe company in Jilin province, promised 5 percent a month, or 60 percent a year. The risk that some vehicles will turn out to be Ponzi schemes leads many investors to be wary. One lunch attendee who gave only her surname, Wang, says her self-imposed cutoff for investments is a promised 20 percent annual return, and adds that she makes site trips to see projects herself. "My experience is, don't stick with any company for too long," she says.

Wang says two people she knows gave money last year to a project that boasted more than a 30 percent return, only to see their principal vanish after only two monthly payments. The private investment company they invested in, **Cheng Ji Da Yi**, became a familiar name among elderly investors after its financing director disappeared with client money late last year, according to police statements. Police didn't disclose how much money was allegedly stolen. Attempts to reach the company were unsuccessful.

"This informal lending segment of the shadow banking system is one of the least transparent and regulated and... among the most risky." *—Stephen Schwartz, Moody's Investors Service*

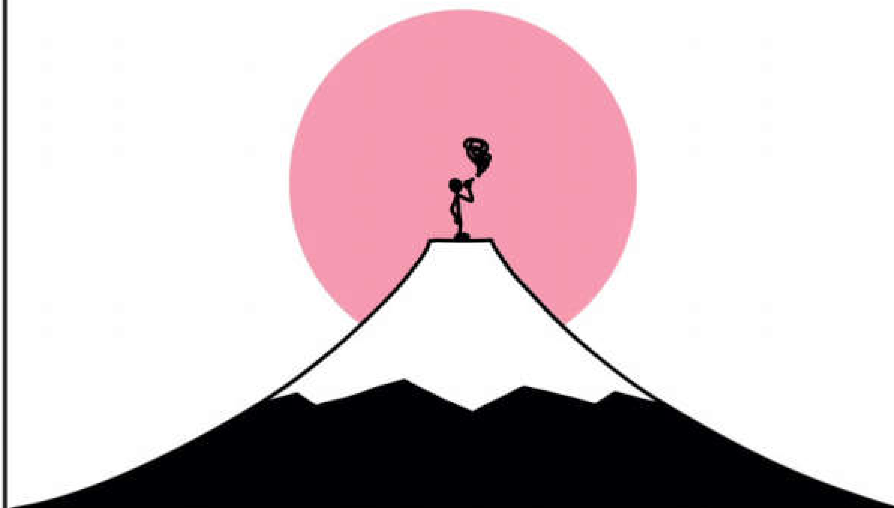
Despite the risks, China's 147 million pensioners are turning increasingly to such unregulated private investments. China's market selloff has made retirees jittery about stocks, while five interest rate cuts since November have reduced the appeal of wealth management products offered by banks. That's led many pensioners to search for yield in the shadow banking system, which includes all lending outside banks and has grown to equal about 65 percent of China's gross domestic product.

"This informal lending segment of the shadow banking system is one of the least transparent and regulated and is likely to be among the most risky for ▶

COURTESY JENA CHOCTAW PINES CASINO. DATA: BLOOMBERG

Bid/Ask

By Kyle Stock



$5b

Japan Tobacco buys rights to Natural American Spirit. JT President Mitsuomi Koizumi said the deal will help the company boost sales in Japan, where American Spirit cigarettes, labeled "additive-free," are popular with urban smokers. JT is paying Reynolds American about 286 times American Spirit's latest pretax profits. Reynolds retains the right to sell the brand in the U.S.

$38b

Energy Transfer buys Williams Cos. Williams turned down a $48 billion bid from its rival in the oil and gas pipeline business before the energy slump deepened.

$4b

Nexstar Broadcasting bids for Media General. The Texas TV giant is trying to expand its local offerings and thwart Media General's efforts to merge with Meredith Corp.

$1.5b

Comcast buys Universal Studios Japan. The deal is for a 51 percent stake in the amusement park, sold by Goldman Sachs.

$1.4b

Kraton Performance Polymers branches out. The company is buying Arizona Chemical Holdings, which makes ingredients for food packaging and car tires.

$767m

ComScore takes the measure of Rentrak. ComScore is known for counting Internet traffic, while Rentrak competes with Nielsen in gauging television viewing.

$343m

An investor goes long on *Business Insider*. German newspaper giant Axel Springer increased its stake in the online news platform to 88 percent.

$95,000

A vintage electric car gets a Tesla-size price. The 1905 Woods Queen Victoria Brougham originally cost $3,000, or $71,000 in today's dollars.

◀ investors," says Stephen Schwartz, a Hong Kong-based senior vice president at Moody's Investors Service.

Many of these investment companies are registered asset managers and risk violating government laws that ban marketing investments to the general public. Under rules set by Chinese regulators, private investment products can be sold only to those with an average annual income of at least 500,000 yuan ($80,000) over the past three years. Companies aren't allowed to make promises about yield or repayment of principal, and a minimum investment of 1 million yuan is required. Often they ignore these qualifications and tout high returns and welcome investments as small as 50,000 yuan, according to investors.

The Chinese government has rarely taken the initiative to "burst the bubble," says Liao Qiang, a Beijing-based analyst for Standard & Poor's. But it's starting to crack down: Nationwide, the number of cases involving companies illegally taking money from the public in which arrests have been approved more than tripled in the first half of 2015, according to a Sept. 24 report from the Supreme People's Procuratorate, China's top prosecutor. In one of the cases, more than 40,000 people allegedly were cheated out of a total of almost 2.6 billion yuan, according to the report.

Last year, the number of illegal fundraising cases under investigation by Beijing antifraud authorities more than tripled from the previous year, to 89. One case involved a company known as **Huarong Puyin** that raised 5.8 billion yuan to fund highway and warehouse projects. Its executives were arrested in July 2014 after the company failed to pay investors, the Chinese-language *Legal Daily* reported. Cases in Beijing climbed 65 percent during the first five months of this year, prompting the local government to begin a crackdown in May.

Wang, the lunch attendee, advises friends to avoid projects that offer overly high returns. "I've been investing like this since 2002, and I never lost," she says. "Just don't be too greedy." —*Bloomberg News*

The bottom line In one recently reported investment scam in China, more than 40,000 people lost a total of almost 2.6 billion yuan.

Edited by Matthew Philips and Eric Gelman
Businessweek.com/markets-and-finance

BID/ASK ILLUSTRATIONS BY OSCAR BOLTON GREEN

New Ideas New Challenges New Fortunes

Who decided "new money" was a pejorative, anyway? On topics from coffee (p78) to inheritance (p74) to so-gaudy-it's-brilliant architecture (p66), this issue features fresh thinking from the young—whether they're hopeful debtors (p60), lonely millionaires (p52), or somewhere in between (p50).

ILLUSTRATIONS BY JACI KESSLER LUBLINER

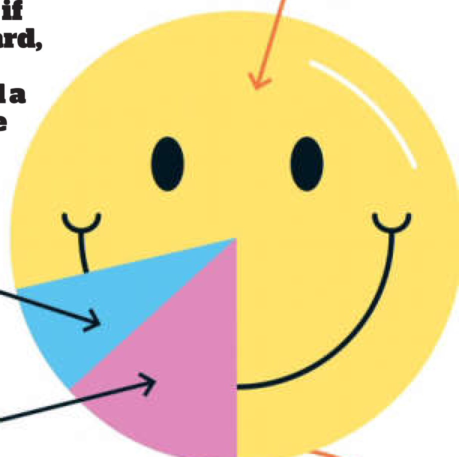
Tame Expectations

Despite debt, stagnant wages, and sluggish economic growth, young people may yet find a path to prosperity

By Peter Coy and Karen Weise

We asked people age 18 to 35...

How confident are you that if you work hard, you will be able to build a comfortable life?



80% Confident

9% Not sure

12% Doubtful

Do you feel young adults today have a brighter or a dimmer future than their parents had at that age?

44% Brighter

47% Dimmer

9% Not sure

"Especially in places like Seattle, I think millennials can find jobs. But I think the long-term growth in terms of the job isn't positive. I don't foresee myself ever being able to afford a house in Seattle. I don't think that I am not going to have a job, but I don't think I'll be financially stable. It's kind of a dead zone."

Neal McNamara, 32
Seattle

How much financial support do you receive from parents or family members?

55% Zero

28% Some help

9% Major support

7% Not sure

The poll is based on interviews with 402 randomly selected people age 18 to 35. The margin of error is plus or minus 4.9 percentage points.

Young Americans' incomes are depressed, their retirement nest eggs are microscopic, and their rate of employment is weak. The trend lines aren't promising, either, which likely explains why there's no shortage of pessimism out there. In a Bloomberg poll of Americans age 18 to 35—the millennial generation—47 percent said they do not expect their cohort to live better than their parents. For one thing, it's hard to imagine outdoing your parents if you're still sleeping under their roof. According to U.S. Census Bureau data, 15 percent of people age 25 to 34 were living with their parents last year, up from 10 percent 30 years earlier. High home prices and strict mortgage lending standards are prime reasons for many millennials' failure to launch. "They are priced out of the kind of housing that they grew up in," says Richard Portes, an economist at London Business School.

Living at home, or living away from home but depending on help from Mom and Dad, keeps many young people from learning how to manage their finances, says Vicki Bogan, an associate professor at Cornell University's Dyson School of Applied Economics and Management. "You don't have any ownership, any force to push you to become financially literate," she says.

Not all young people have student debt, but for those who do, it can be paralyzing. Jessica Xydias, 25, says she didn't take out a lot of student loans, "but my husband did. I look at our accounts all the time. It feels crushing

Which of the following ranges best represents your individual income? (Among employed.)

Zero to $14,999	15%
$15,000 to $29,999	25%
$30,000 to $49,999	22%
$50,000 or more	32%
Not sure	5%

> “I have quite a few successful friends who aren’t struggling moneywise, but who don’t like their jobs at all. I don’t know of many people who are really doing well financially and like what they are doing.”
>
> **Bailey Romatoski, 22**
> Las Vegas

How much of your income do you save on a regular basis? (Among employed.)

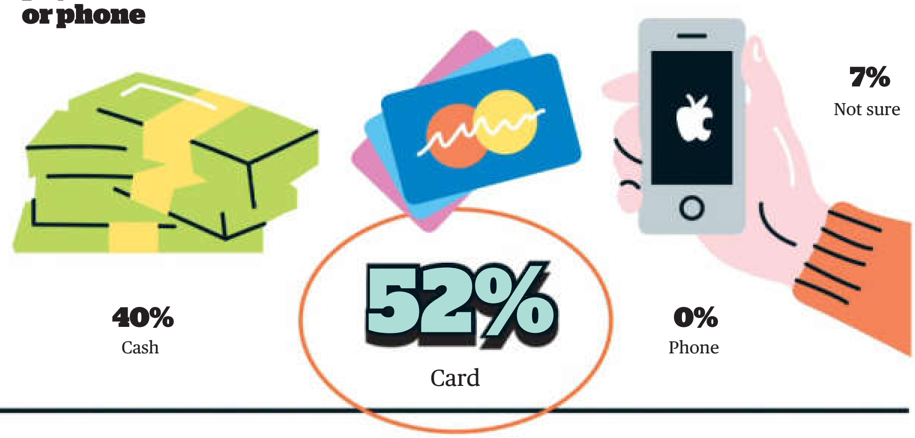
Zero	21%
1%-5%	22%
6%-10%	24%
11%-19%	14%
20% or more	14%
Not sure	5%

> “It’s taken 10 years to progress in my industry and find job security. Without that, I wouldn’t have the means to manage my debt.”
>
> **Stephen Gomez, 31**
> Fort Worth

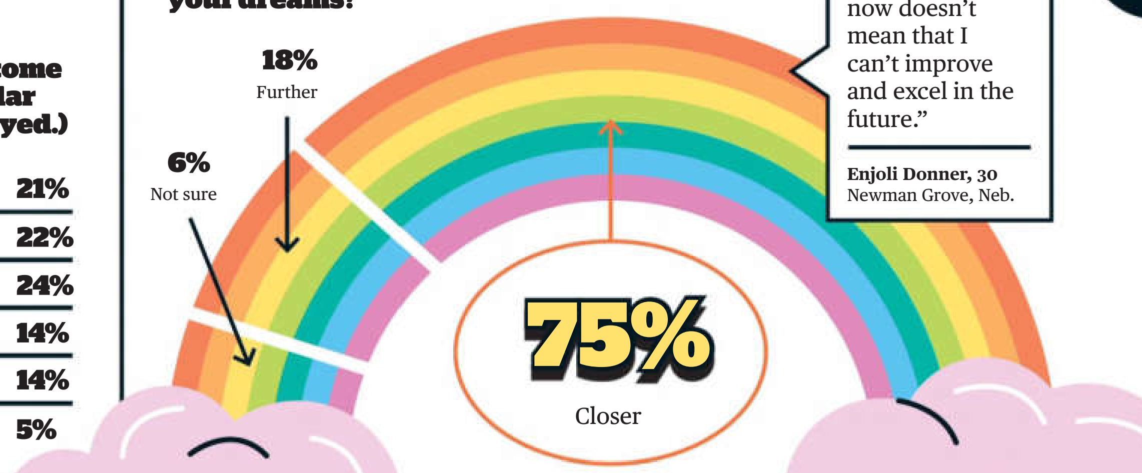
How would you describe your debt situation?

Have no debt	28%
Manage the current debt	41%
Struggling a bit with debt	17%
Overwhelmed by debt	6%
Not sure	8%

When making a purchase, how do you prefer to pay—cash, card, or phone



Do you feel you are moving closer to your hopes for your career and/or finances, or do you feel you are moving further away from your dreams?



> “Just because I am in one place now doesn’t mean that I can’t improve and excel in the future.”
>
> **Enjoli Donner, 30**
> Newman Grove, Neb.

and insurmountable.” And the debt crimps their ability to save. While paying off loans, she says, “it is extremely difficult, if not impossible, to put money into your Roth account.”

One thing millennials do have in their favor, of course, is time. Modest economic expansion that exceeds population growth “is more than enough to support a higher standard of living for our children over time,” says Gus Faucher, senior macroeconomist at PNC Financial Services. Whether young people dig out from their deficit and end up surpassing their parents’ generation depends on some unknowable things. Will globalization and automation kill or create jobs? Will humankind be saved by nuclear fusion and a cure for Alzheimer’s, or be doomed by climate change, wars over resources, and the crippling cost of elder care?

One way to look ahead—and restore some optimism—is to look back to millennial parents’ salad days. Median wages and assets were higher, adjusted for inflation. But would you trade that life for the one you have? Would you give up your smartphone, your GPS, Google, Amazon.com, fresh peas in winter, and Ford F-150s with aluminum bodies that won’t rust?

It’s just as likely to envision a similar set of innovations 30 years from now that people can’t imagine living without. If so, then no matter what the official statistics say, the best years just might lie ahead. Ⓑ

Children of the Yuan Percent

The fuerdai, *China's second-generation rich kids, are the most loathed group in the country. They're also its future*

By Christopher Beam
Photographs by Ka Xiaoxi

Wang Daqi in the lobby of his apartment building

Emerging from a nightclub near Workers' Stadium in Beijing at 1:30 a.m. on a Saturday in June, Mikael Hveem ordered an Uber. He selected the cheapest car option and was surprised when the vehicle that rolled up was a dark blue Maserati. The driver, a young, baby-faced Chinese man, introduced himself as Jason. Hveem asked him why he was driving an Uber—he obviously didn't need the cash. Jason said he did it to meet people, especially girls. Driving around late at night in Beijing's nightclub district, he figured he'd find the kind of woman who would be charmed by a clean-cut 22-year-old in a sports car.

When I heard this story from a friend who had also been in the car, I asked for the driver's contact info. I introduced myself to Jason over WeChat, China's popular mobile app, and asked for an interview. He replied immediately with a screen shot that included photos of women in various states of undress. "Best hookers in bj :)," he added. I explained there had been a misunderstanding, and we arranged to have coffee.

When we met at a cafe in Beijing's business district, it was clear that Jason, whose surname is Zhang, was different from other young Chinese. He had a job, at a media company that produced reality TV shows, but didn't seem especially busy. He'd studied in the U.S., but at a golf academy in Florida, and he'd dropped out after two years. His father was the head of a major HR company, and his mother was a government official. He wore a $5,500 IWC watch because, he said, he'd lost his expensive one. I asked him how much money he had. "I don't know," he said. "More than I can spend." So this was it: I had found, in the wild, one of the elusive breed known in China as the *fuerdai*, or "second-generation rich."

As portrayed in the local press, fuerdai are to China what Paris Hilton was to the U.S. a decade ago, only less tasteful. Every few months there's a fuerdai scandal, whether it's a photo of a woman about to set fire to a pile of 100-yuan ($16) notes; members of the much derided Sports Car Club posing beside their Lamborghinis; or someone pulling a gun during a street race. In 2013 reports of a fuerdai sex party at the beach resort of Sanya provoked a nationwide finger-wag. Two prominent rich kids got into a public arms race over who had the bigger stash: The widely despised socialite Guo Meimei posted photos online of herself with 5 million yuan worth of casino chips; her rival responded with a screen shot of his bank statement, which appeared to contain 3.7 billion yuan. (Guo was sentenced to five years in prison for running a gambling den.) Recently, the son of Wang Jianlin, a real estate mogul and the richest man in China, trolled the nation by posting a photo of his dog wearing two gold Apple Watches, one on each forepaw. Fuerdai outrages occasionally feature government intrigue, such as a 2012 Ferrari crash in Beijing involving two young women and the son of a high-level official, all of whom were at least partially naked when they were thrown from the car. The man's father, a top aide to then-president Hu Jintao, was later arrested and charged with corruption.

Age 22

The fuerdai (pronounced foo-arr-dye) aren't just an embarrassment. The Communist Party seems to consider them an economic or even political threat. President Xi Jinping himself spoke out this year, advising the second generation to "think about the source of their wealth and how to behave after becoming affluent." An article published by the United Front Work Department, the bureau that manages relations between the party and nonparty elite, warned: "They know only how to show off their wealth but don't know how to create wealth." Some local governments have taken steps to reeducate their wealthy elite. In June, according to *Beijing Youth Daily*, 70 heirs to major Chinese companies attended lectures on filial piety and the role of traditional values in business.

While Xi's anticorruption campaign has curbed some of the most outrageous wealth-flaunting, the gap between rich and poor is still evident to anyone on a Beijing street weaving between fruit vendor carts and black Audis. Now, as the economy slows and the party looks for scapegoats, the fuerdai are in the precarious position of having to justify their existence and show that China's future leaders aren't just money-igniting, Ferrari-wrecking layabouts. Not all of them, anyway.

After a few weeks of nosing around, I persuaded a crew of fuerdai to invite me to one of their occasional dinners. When I arrived, I wondered if I'd come to the wrong place. It was an outdoor barbecue spot in northern Beijing, with locals sitting on stools so low they were almost squatting, swilling Yanjing beer and chewing on lamb skewers. Identifying the centimillionaire scions among the riffraff was difficult. The fuerdai trickled in, dressed the same as everyone else in the restaurant—in tank tops, button-downs, jeans, flip-flops. The only giveaway was the liquor they brought: French Champagne and a bottle of Maotai, the choicest brand of *baijiu*. Martin Hang, the gregarious organizer of the dinner and editor of a magazine called *Fortune Generation* (no relation to the U.S. publication), introduced everyone. The dozen guests included Wang Daqi, 30, son of a

famous business consultant, who had recently written a book about rich kids in China; Albert Tang, 20, a philosophy student at Bard whose father runs a major Beijing publishing house; and Sophia Cheng, 27, the only woman in the group. It still wasn't clear to me what threshold of wealth one needed to exceed to be fuerdai, but Cheng assured me she qualified. (Hang disagreed.) Her parents had given her a vast amount—more than 100 million yuan, she said—which she invested in film, mobile-gaming, and meat-processing companies.

Drinking began in earnest before the food arrived. We toasted as a group, then in pairs, then in subgroups, then in pairs again, until everyone was so shattered that it felt like we'd known each other forever. Conversation volleyed between business and gossip. One member of the group was dubbed the Champagne Prince for his ordering habits at clubs. Another attendee, Lin Xin, 30, talked up his company's technology for authenticating antiques. Someone joked about how wannabe rich kids would go to clubs and rent bottles of expensive liquor to display on their table to make it look like they had money. ("But what if a girl wants to drink it?" another person wondered.) Cheng mentioned that she had a few spare chickens in her car; did anyone want to try some? Tang, the philosophy student, pulled me aside and asked what I knew about the Freemasons.

At the center of it all was Hang, who, as editor of *Fortune Generation* and a prominent member of the Relay China Elite Association, a nonprofit that serves as a social club for the second-generation rich, functions as a connector among China's children of privilege. Hang, 31, explained how Relay works. "We're trying to help the second generation do better together," he said, speaking carefully and with precision, even after many drinks. Founded in 2008, Relay was created to help fuerdai meet other fuerdai, who might be facing similar challenges of wealth. There's an initiation fee of 200,000 yuan, and members must prove that their family businesses pay at least 50 million yuan in annual taxes. At forums held several times a year, the heirs listen to lectures on topics such as how to minimize taxes or maximize profit ("All legal stuff," one member assured me) and visit each other's companies. "Most of the time the forum is very boring," Hang said. He rolled out the magazine in 2011, hoping to promote a more positive image of fuerdai than the decadent wastrels usually portrayed in the media. It was a rebranding: Relay's members dropped the *fu* ("wealthy") from fuerdai and started to refer to themselves using a new term, *chuangerdai*, which means "second-generation entrepreneurs," or just *erdai*, "second generation." Each month the magazine cover features a different child of privilege, usually male, wearing a suit and striking a casually authoritative pose—for the July issue, while leaning on an Audi. (The two-page ad immediately following the cover is also for Audi.)

Models hired to attend Hang's birthday party

The purpose of the organization, Hang said, is to encourage second-generation kids to take over the family business or at least play a role in its management. Such companies are crucial to the Chinese economy, he said: Not only do they make up 85 percent of non-state-owned enterprises, they also put long-term success ahead of quarterly results.

The son of China's richest man posted photos of his dog wearing two gold Apple Watches, one on each forepaw

The downside is that family-run companies are, well, run by families, and most kids in China don't relish the idea of working alongside their parents. Hang took issue with the statistic, released by Shanghai Jiaotong University in 2012, that 82 percent of second-generation heirs aren't willing to take over their family business. He didn't dispute the data so much as the semantics: "They aren't willing to do it, but they still have to."

It's a distinction that Hang knows well. His father's advertising agency, started in 1993, is one of the largest of its kind in Jiangxi province. After graduating from college, Hang avoided the agency. He studied financial management in the Netherlands and bought the rights to Norron, a Norse god-themed online game. He was cocky about his business acumen. "I thought I was awesome," he said. "I was a fuerdai—I wasn't interested in talking to other people." When the game failed to take off, Hang decided to join his father's company. "I had a choice," he said. "I could do something else, but it would make my parents work very hard. They never said I had to, but I thought it was necessary."

All fuerdai face a version of the same problem: They have everything but the ability to surpass their own parents. Whatever they achieve will be credited to their family, not to themselves. Hang described always being introduced as "the son of Mr. Hang." When Wang, the author, found a publisher for his book, he didn't know if they wanted to publish it because it was good, or because of his famous father. "People will always say your only competence is that you were reincarnated into a good family," he said. He told me about the difficulty of explaining the burdens of inheritance to the nonwealthy. "They never understand—'Why are you in pain?'" said Wang. "I say it's not relevant. The amount of wealth doesn't determine how happy you are. You can only know by experiencing it."

It's no surprise that most fuerdai, after summering in Bali and wintering in the Alps, reading philosophy at Oxford and getting MBAs from Stanford, are reluctant to take over the family toothpaste cap factory. Ping Fan, 36, who serves as executive deputy director of Relay, moved to Shanghai to start his own investment firm rather than work at his father's real estate company in Liaoning province. He picked Shanghai, he said, "because it was far from my family." After graduating from Columbia University, Even Jiang, 28, briefly considered joining her mother's diamond import business, but they disagreed about the direction of the company. Instead, she went to work at Merrill Lynch, then returned to Shanghai to start a concierge service, inspired by the American Express service she used when living in Manhattan. Liu Jiawen, 32, whose parents own a successful clothing company in Hunan province, tried to start her own clothing line after graduating. "I wanted to show I could do it on my own," she said. The company failed.

Along with riches, fuerdai often inherit a surplus of emotional trauma. The first generation of Chinese entrepreneurs came of age during a time that rewarded callousness. "They were the generation of the Cultural Revolution," said Wang. "During that time, there was no humanity." His grandfather, the principal of a middle school in Guizhou province, was humiliated by Red Guards. "They were raised cruelly—there was no mercy. It was survival of the fittest." Many fuerdai have their parents' same coldness, Wang said: "They're really hard to be friends with."

Zhang, the Uber driver, was sent to boarding school starting in kindergarten, even though his parents lived only a short distance from the school. Perhaps to compensate for their inattention, they gave him everything he wanted, including hundreds of toy cars. Last Christmas he bought himself the Maserati. "It's like their childhood has not ended," Wang said of his fellow rich kids. "Their childhood was not fully satisfied, so they always want to prolong the process of being children." Thanks to China's one-child policy, most fuerdai grew up without siblings. That's why so many travel in packs on Saturday nights, Wang said. "They want to be taken care of. They want to be loved."

For Zhang, partying is a way of staving off boredom. He used to go out clubbing five nights a week. "If I didn't go, I couldn't sleep," he said. He doesn't lack for companionship, he added. Two or three times a week, he'll hire a high-end sex worker—a "booty call," in his words—for $1,000 or more. Zhang prefers paying for sex to flirting with a girl under the pretense that he might date her. "This way is more direct," he said. "I think this is a way of respecting women." But some nights, sitting at home alone, he scrolls through the contacts on his phone only to reach the bottom without finding anyone he wants to call. When we first spoke, he said he had a girlfriend of three years who treated him well, but that he didn't love her. "You're the first person I've told that to," he said.

Most fuerdai don't talk about their problems so openly. "They have trust issues," said Wayne Chen, 32, a second-generation investor from Shanghai. "They need a place to talk. They need a group." Relay offers a setting in which they can speak honestly, without having to pretend. "It's similar to a rehab center," he said.

In July, Jiang noticed that business at a barbecue restaurant she owns in Shanghai was slower than usual. "It was only half of the crowd," she said. The stock market had been falling since June and was down 38 percent from its peak by the end of the summer. Over dinner at the

restaurant, I asked Jiang and Chen, who are a couple, as well as Hang, if fuerdai had felt the pain of the market crash. "Of course," Jiang said. "A lot of their family companies are listed." She herself had bought stocks, she said, but pulled out when the market got too bumpy. Chen said his family money was invested in a "risk-averse way," much of it in fixed-income assets and funds of funds.

Still, the volatility—and more important, the government's clumsy response to it—signaled a deeper discord within China's slowing economy, which affects the fuerdai as much as anyone. Raising money is tougher than before, said Jiang. Hang said the slowdown has hurt ad sales at the magazine, particularly from real estate companies.

Many fuerdai have moved money overseas—Boston Consulting Group put the amount of Chinese money invested abroad at $450 billion in 2013—often with the goal of gaining foreign citizenship. A survey conducted in 2013 found that 64 percent of Chinese high-net-worth individuals had emigrated or wanted to emigrate overseas. I asked Hang, Chen, and Jiang if fuerdai worry about their money. "Some do," Hang said. "His dad sent him to the U.S." He laughed and pointed at Chen, who is now an American citizen. Hang, who is married and has a 4-year-old son, said he hasn't ruled out emigrating.

It's not just China's stock market drop that makes fuerdai jittery. "It's society, too," said Chen. "Like the Occupy Wall Street protests." There's always been a tendency in Chinese society to "hate the rich," Hang said. It's the same sentiment that fueled the Cultural Revolution, and was once practically the Communist Party's mission statement. (Emphasis on "was.")

Exacerbating the problem, most fuerdai don't mix much with the working classes. "When we were children, we went to the best schools, so we didn't encounter a lot of poor people," Hang said. "This is very dangerous for society." Relay is therefore planning to start a program fostering ties between fuerdai and children from the countryside. It also organizes charity drives. After a chemical factory exploded in Tianjin in August, killing more than 100 people, its members donated 1.5 million yuan through the local government. To hear Hang explain it, philanthropy is about more than just social responsibility—it's about social stability.

That said, when I asked Jiang if she thought inequality was a problem in China, she was ambivalent. "I don't know," she said. "There are two groups of poor people. One is, you don't work hard. You deserve to be poor because you don't work hard. Second is, you work hard but can't succeed. I think we should help the second group of people.... There's a saying, *jiu ji bu jiu pin*—'We'll help you if you have an emergency, but we cannot help you if you're poor.' "

"They know only how to show off their wealth but don't know how to create wealth"

One day this summer, at the urging of a friend, Wang decided to call his father and tell him he loved him. Wang senior picked up the phone. "I love you, Dad," Daqi said. There was a pause. "Are you drunk?" his father asked. Wang told this story at a gathering at his father's complex on a Friday night in August. The guests were friends he had met through Lifespring, a self-help company that, with introductory classes costing upward of $1,000, caters largely to fuerdai. (The original Lifespring was the subject of numerous lawsuits in the U.S. in the 1980s and '90s, including charges of wrongful death, and went out of business in 1998.) Wang said the group has helped him reconcile his feelings about his father and has also provided the support and community he was unable to find at, say, the club.

With instant gratification never more than a credit card swipe away, the search for meaning is arguably harder for fuerdai than it is for most people. Some, like Jiang and Wang, feel most purposeful when deviating from their parents' path. For others, returning to the family business is, to their surprise, a source of satisfaction. Liu said she's glad she took over her family's clothing company because it made her parents happy—a sentiment her former rebellious self would probably have scoffed at.

Not everyone has discovered a purpose. Zhang, the Uber driver, said his job at the TV production company is hardly his ideal career. But he's not sure what is. "As a kid, I had a lot of dreams," he said when we met up at the cafe near his office. "I wanted to be a golfer or a race car driver or a doctor, something like that.... But when you get older, you see more, and you see that some goals are just a dream." He lit up a cigarette—now illegal indoors in Beijing—barely casting a glance to see if a waiter would stop him. Zhang never had any limitations, which was perhaps itself a limitation. "I don't really have a plan," he said. "Probably it's a sad thing, but it's the truth." When I asked him if he's happy, he said it's all a question of attitude. "You can find a million reasons to be sad," he said, "but you only have to find one reason to be happy. Every day I find one." I asked him what today's reason was. "Today, I meet you," he said. "It's a happy thing." Ⓑ

The Debtors Strike Back

Activists want to turn billions in unpaid student loans into a catalyst for political action

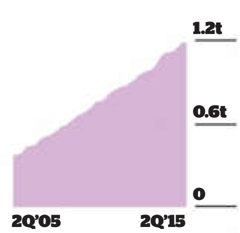
By Natalie Kitroeff

When the U.S. Department of Education announced in June the creation of a formal process for students defrauded by their college or university to seek loan forgiveness, it was a victory for the activist group Debt Collective. The impact of the policy could be huge: Granting forgiveness to everyone who attended Corinthian Colleges in the past five years—the for-profit company that filed for bankruptcy in May amid charges of predatory behavior—would wipe out $3.2 billion in debt owed to the U.S. government.

For members of the Debt Collective, which has been fighting for loan relief since its founding last year, it wasn't nearly enough. The piecemeal approach of requiring individual borrowers to apply for loan forgiveness seemed unacceptably burdensome. "The right thing to do would be to issue a classwide discharge and understand that this happened to a group of people," says Ann Larson, 41, one of the organization's leaders. "No one who is paying attention can possibly think that the Department of Education is doing all it can." The Debt Collective's overarching goal, she says, is to persuade the millions of Americans who are severely late on their student loan payments to "revolt"—to turn the billions they collectively owe from a burden into a source of political power.

At the moment, the strategy is working. Amid inertia in the world of education finance, with total student debt balances now reaching $1.2 trillion, the Debt Collective has become a leading voice for student debtors, earning the respect of consumer advocates and state attorneys general alike. "It is quite an accomplishment to have gotten the department to this point," says Robyn Smith, an attorney with the National Consumer Law Center who's consulted with the group. The Debt Collective "has played a major role in keeping public attention on this issue and keeping the department's feet to the fire."

U.S. student loan debt outstanding



DATA: FEDERAL RESERVE BANK OF NEW YORK

For a movement made up of delinquent borrowers, the Debt Collective is surprisingly optimistic about the role it can play. The group has roots in Occupy Wall Street, the protest that began in New York City's Zuccotti Park in September 2011. While camped out to spotlight bankers' misdeeds and wealth inequality in America, Larson began thinking about unionizing student borrowers. The activists she met tended to have educational debt themselves, and they realized their shared experience of unmitigated frustration and powerlessness could inspire a broad social movement.

After the police kicked Occupy out of the park in November 2011, Larson and another activist, Laura Hanna, spent two years buying and canceling $17.2 million of student loans, through a donation-funded campaign called the Rolling Jubilee. Their third partner, Astra Taylor, handled public relations—she was a minor celebrity in Occupy circles, for her occasional appearances with her husband's band, Neutral Milk Hotel, and as the maker of two documentaries about philosophy. The trio launched the Debt Collective on Sept. 17, 2014, three years to the day after Occupy protesters first assembled in Zuccotti Park. The date was "a little dog whistle," Larson says, "for the tons of people who became aware of social class that year."

By that point, Corinthian Colleges was flaming out. The company, with more than 70,000 students on 107 campuses across the country, was facing investigations into its recruitment practices and job placement rates by the Securities and Exchange Commis-

sion, the Consumer Financial Protection Bureau (CFPB), and several states. Corinthian has said the allegations against it are false and politically motivated. In June 2014, after the U.S. government suspended its payments of federal financial aid to Corinthian, the company collapsed. Even before the Debt Collective had officially launched, its members were agitating on behalf of Corinthian's hundreds of thousands of graduates. The group brought seven of the company's grads to a public hearing the Department of Education was holding in Anaheim, Calif., in November 2014; there, they demanded to know why they had to repay student loans to a tarnished school that the government had cut off from its financial aid spigot. In February 2015, the Debt Collective announced that 15 former Corinthian students were going on a student debt "strike," meaning they'd stop making their loan payments. "This public strike by the Corinthian 15 marks the beginning of a new era of debtor solidarity and collective disobedience," Luke Herrine, a New York University law school graduate working with the group, said at the time.

The declaration wasn't as revolutionary as it sounded. The 15 graduates were already striking in a sense—they were all either seriously late on their loan payments or had been granted forbearance, a grace period during which a debtor doesn't have to make payments. But from a political and marketing perspective, the strike was shrewd. One person behind on her loan payments looks like a failure; many such people banded together start to make a point. The blame should fall not on them, they can argue, but on a system that saddled them with unrealistic obligations. It's a play on the old maxim: "If you owe the bank $100, that's your problem. If you owe the bank $100 million, that's the bank's problem."

Convincing the public that broke borrowers are victims rather than deadbeats won't be easy. "Right now a lot of the mythology is that you can't pay your debt because you aren't working hard enough, or you made a mistake or are irresponsible," Larson says. "A lot of the challenge is changing how we think about debt and reversing some of the shame that people feel."

Corinthian alums didn't need much convincing. In the month after announcing the strike, Hanna says, the Corinthian 15 turned into the Corinthian 100, as the Debt Collective received a flood of requests to join the movement from former students.

On March 3, Larson and Hanna got a major break: an e-mail from Rohit Chopra, then the student loan ombudsman at the CFPB. He invited the activists to Washington to discuss "the burden of their federal student loans"—and said he'd happily invite "other federal agencies" to the chat. That was a big deal. While the CFPB was a young outfit, established by President Obama in 2011, other arms of the federal government were less receptive to Occupy Wall Street alumni. Chopra was offering to get the Debt Collective into the halls of power. "Reports by former students of strong-arm tactics by for-profit college employees often have frightening similarities," Chopra says, "which suggests that problems are not limited to a few bad apples, but stem from orders from headquarters."

The Debt Collective had spent months focused on an obscure provision in federal law called Defense to Repayment, which allows a student to submit a formal request for loan forgiveness if she can show her school violated state law. Before 2015, the Department of Education had received five such requests. At a meeting Chopra arranged in March, Debt Collective members delivered 250 written claims to Under Secretary of Education Ted Mitchell. "It was a huge step for us, actually getting a head officer to listen," Larson says. "Policymakers are making decisions behind closed doors, and they don't actually have to meet the people who are affected."

Mitchell agrees. "I think one of the dangers in policymaking is that you forget the impact of what you do on a day-to-day basis on real people, real lives," he says. "Those students' stories remind us both of what happened to them and of what we need to do to give them every opportunity to start over."

The Education Department announced its debt relief program in June; it's since received more than 4,000 requests for loan cancellation. Larson and the other Debt Collective activists remain disappointed with the program's scope—as do several state attorneys general. "We haven't seen enough from the Department of Education so far," says Massachusetts Attorney General Maura Healey, who sued Corinthian last year for misleading students. "It's taken too long, it's been too unwieldy, and so far we haven't seen any loans discharged."

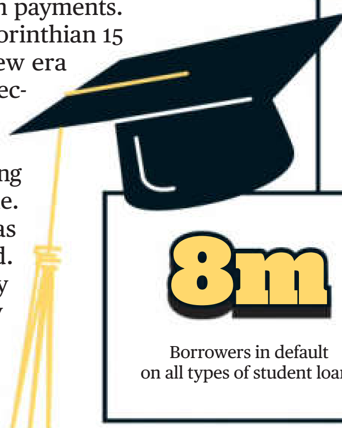
Mitchell says debt relief will take time. "Creating a process for this is unprecedented," he says. It must be "fair to students and taxpayers." The Education Department, he adds, is still looking for ways to forgive federal loans on a classwide basis. The department has already made it easier for students who attended one Corinthian chain, Heald, to get relief as a class. It says it doesn't yet have evidence to prove that Corinthian subjected groups of students at its other two college franchises, Everest or Wyotech, to the same deceptive tactics.

Larson and Hanna say department officials should have gotten their hands on the results of Corinthian investigations years ago, as federal and state investigators compiled their long-running cases. That it's taken this long to hold Corinthian accountable is, for the activists, a clear sign that there's still much to do.

"It seems like what they respond to is mass numbers of angry students making demands, and that's the only thing," Larson says. There are a lot of potential recruits: Eight million Americans are in default on their student loans. "We are working on it, and they haven't heard the last from us." B

$29k
Average federal student debt per borrower

11.6m
Borrowers who are current on federal direct loan payments



8m
Borrowers in default on all types of student loans

42.4k
Average annual tuition, fees, and room and board at private, nonprofit colleges

$38.6k
Average starting salary for 2015 graduate with a degree in humanities

DATA: U.S. DEPARTMENT OF EDUCATION; CFPB; NATIONAL ASSOCIATION OF COLLEGES & EMPLOYERS

The Hipster Fixer-Uppers

Young real estate developers are using young investors' money to put young people in young neighborhoods

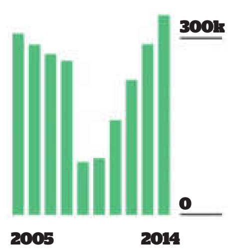
By Ben Steverman

John Chaffetz is showing off an apartment building that his development firm, Timberlane Partners, just bought for $7.2 million. He admits it doesn't look so hot. "This has been treated like a prison camp," he says of the 32-unit building in Los Angeles's Echo Park neighborhood. Steel bars stick out of a cinder-block fence, threatening to impale someone. The front door is an ugly metal gate.

But an organic supermarket opened around the corner in November, and a Blue Bottle Coffee just arrived down the block. There's a farmers market nearby each Friday, and five minutes up Sunset Boulevard is the Silver Lake neighborhood, a nest of hipster cafes and places to buy rare cheese and handmade clothes. Timberlane plans to tear down the building's security fencing, put terracotta back on the roof, and repair windows that date to its pre-1930 construction. "The goal," Chaffetz says, "is for this to look like a Moroccan boutique hotel."

If you're the sort of twentysomething who needs rhubarb bitters in her cocktail, you're not going to live just anywhere—and Timberlane co-founders Chaffetz, 32, and Dave Enslow, 37, are counting on that. Much of their Seattle- and Los Angeles-based firm's strategy is straight out of the developer playbook: buy neglected apartment buildings in promising neighborhoods, renovate, raise rents, and fill them with young professionals. But when fixing up a property, Timberlane takes extra care to provide touches it can market specifically to the perceived whims of millennial tenants. Historically accurate details are a priority. Midcentury Palm Springs architecture inspired the revamp of one dated building, replacing "a lobby that looked like a 1982 funeral home," Chaffetz says. The company will typically expose brick walls and refinish hardwood floors rather than slap down carpet. It adds amenities for healthier lifestyles. At one site, Timberlane sacrificed five apartments to create a 3,000-square-foot gym with a yoga studio and climbing wall. A building on a popular Seattle bike path got a large bicycle storage and repair room. Where older renters might value ease of parking, millennials want walkable neighborhoods. "They want to drop off their car on a Friday and not see it again until Monday," Enslow says.

U.S. multifamily housing starts



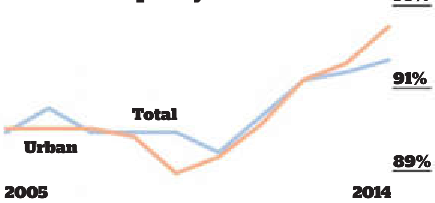
So far, the strategy's working. The four-year-old firm earned a 24 percent return on its first five buildings. An additional seven sites, owned for at least a year, are producing annual yields—cash as a share of investment—of 11.2 percent. Investors funded an expansion into Salt Lake City in 2013 and Los Angeles in 2014, and Timberlane now has a real estate portfolio of $160 million, up from less than $80 million at the end of 2013.

The firm started with a much less hip strategy. Its first investments were in the Seattle suburbs, in generic apartment buildings with large parking lots and nothing to walk to. Enslow's family had owned similar complexes in the area for decades. But both Enslow and Chaffetz, a former Morgan Stanley banker, were living near the trendy Capitol Hill neighborhood. They and their friends had no interest in a "home out in the suburbs with a white-picket fence," Enslow says.

They started hunting for properties they themselves would want to live in, with prime locations and unique amenities. Together they bought an old house. They painted the walls a stark white, added a modern cedar fence, and kept an old potbelly stove. It rented "in a nanosecond," Chaffetz says, to Amazon.com employees fresh out of college. The pair bought another building that housed a gourmet sandwich eatery and a local Seattle landmark, a woman-friendly sex shop. "Distinctiveness is always valuable," Chaffetz says. "It's something that new can't compete with."

Timberlane's investors are young, just like its tenants; Chaffetz estimates that about half the money raised comes

Rental occupancy rates



DATA: U.S. CENSUS

from clients under 40. An example is John Knorring, 33, a commodities trader in New York who's been investing with Timberlane for three years. He had to be convinced that the firm had the right strategy to expand in Los Angeles. "You can't just buy in any city, anywhere," he says. "You have to buy the right spot and position it in a way that people want to live there."

Timberlane looks for buildings with studio and one-bedroom apartments and finds tenants willing to sacrifice space for proximity to cool bars and restaurants. "The unit is more of a place to crash and take a shower than a place to hang out and entertain," Enslow says. Timberlane has added roof decks, entertainment rooms, fire pits, and other communal spaces to some buildings. "We were looking for ways to extend the living space, so people don't feel locked up in their apartment," says Gerard La Caille of the design firm Saltaire Craftsmen, which worked on some of the renovations. Such touches allow Timberlane to raise rents in the buildings it buys, usually by 15 percent to 20 percent.

The risk to Timberlane is that today's millennial lifestyle priorities could change as the group ages. If tenants want to stay in cities after they have children, they'll need good schools. A resurgence of crime could also make urban living less appealing. And with many workers' wages flat, there's a risk of cool neighborhoods getting simply too expensive to continue drawing the young. "The rents still have to match up" with what people can afford, says Pete Reeb of John Burns Real Estate Consulting.

Enslow and Chaffetz say they worry that prices have peaked in many places. They've looked at expanding into Denver and San Francisco. "But we're very cautious," Chaffetz says, partly because of high property prices and partly because they don't yet have expertise in those markets.

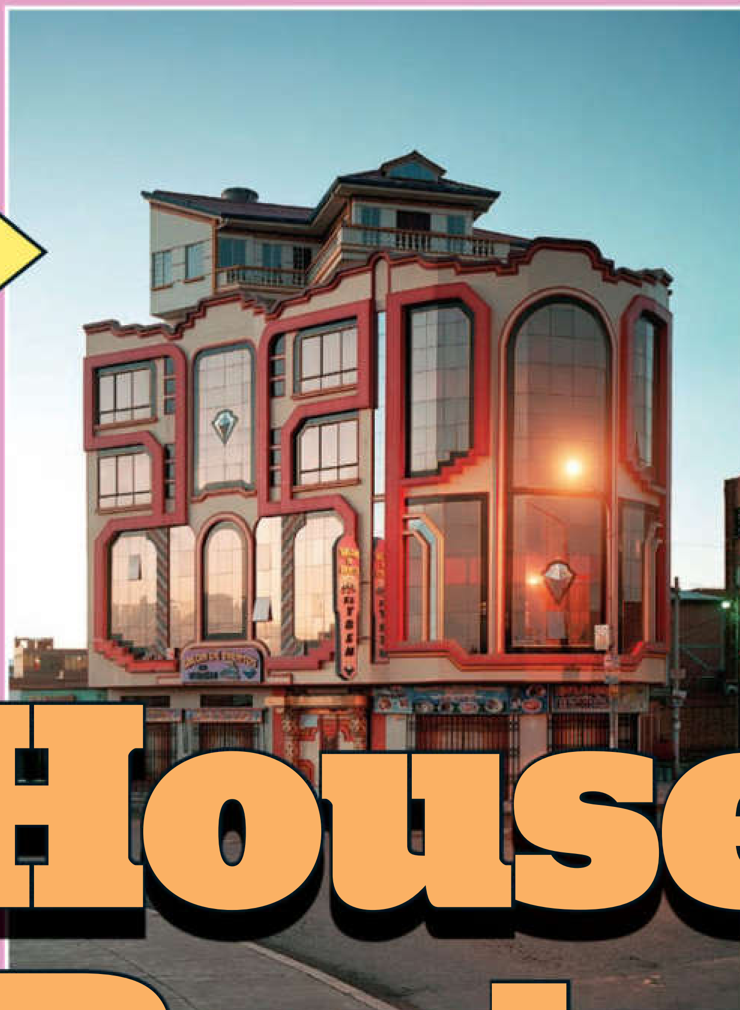
Timberlane's bet, though, is that a cool apartment in a walkable urban neighborhood will always be valuable. It's putting together a portfolio it plans to hold for decades, Chaffetz says. "I don't see a really charming property in Silver Lake being undesirable in 10 years just because millennials got older." Ⓑ

Timberlane properties in Seattle (above and below) and Los Angeles (below right)

THE NEW MONEY ISSUE

ARCHITECTURE

Age 3



House Party

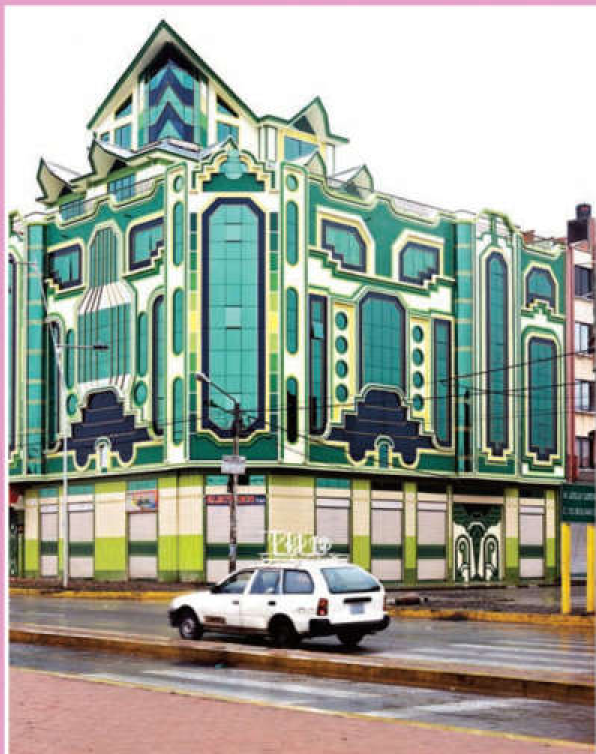
Bolivia's Aymara people are building psychedelic mansions to celebrate their newfound wealth

Photographs by Livia Corona Benjamin

In Bolivia, almost a decade after the election of Evo Morales, the country's first indigenous president, the economy is enjoying a natural-gas-fueled boom that's unprecedented—both in its scale and the participation of native groups. That's on display vividly in El Alto, a city of 1 million near the border with Peru. Vibrant homes are sprouting up, expressing the good fortune and cultural pride of the Aymara people, as well as the flamboyant vision of architect Freddy Mamani. His intricately detailed buildings have injected color into this drab city, which at 13,615 feet is the highest in the world. Bolivia's old money dismisses the towering structures as nouveau riche eyesores, but foreign critics are hailing a New Andean Architecture. —*Catherine Elton*

Mamani's houses are working assets. Averaging more than 29,000 square feet, they boast two-story party halls that are rented out for weddings and other functions. "I don't have a pension," says Angel Quisbert, the owner of a leatherwork business who commissioned Mamani to build this seven-story home in El Alto. "My wife and I think we can live on renting the space."


Mamani's vivid hues are derived from traditional Aymara textiles, and he uses plenty of wattage to show them off. A typical party hall has several chandeliers, 1,500 recessed fixtures, and more than 6,000 feet of LED lights, some of which flash and change colors.



"I started out with nothing," says Alejandro Chino, a tailor who makes suits. "My wife and I worked long days, weekends, and holidays. That's how we made money." Chino and others say their Mamani-designed homes, which can cost as much as $500,000, send the message that with hard work and an enterprising spirit anyone can get ahead in Bolivia.

Owners' quarters in Mamani's buildings are on the top floors—under construction in this house—which have sweeping views of El Alto and the snow-capped Andes. Along with party halls, the lower floors have commercial spaces and apartments, either for family members or to rent. Mamani says the geometric designs of the facades of his buildings are inspired by the nearby Tiahuanaco archeological ruins.

The father of New Andean Architecture, Mamani (center) has built 100-plus homes in the past 13 years. "There is this doctrine in the universities that we can't break certain architectural norms, that we have to base our work on what already exists," says Mamani, who is Aymaran and has degrees in architecture and engineering. "I believe we have to innovate."

When Picasso Is Too Pedestrian

Lots of Wall Streeters drop huge sums on art. Paul Leong is doing something more challenging

By James Tarmy
Photographs by Jeremy Liebman

It definitely doesn't look like an investment banker's apartment. In Paul Leong's Tribeca home, there's a three-foot-long plastic army tank mounted above his bedroom door and, leading up to it, tread tracks embedded in the wall. "We had to channel the wall, put plaster in, run the tank through the plaster, and then refinish the wall," Leong says proudly. The tank and tracks are an artwork by the conceptual artist Lutz Bacher and one of the more accessible pieces of the 30-plus works of art on display in Leong's home. A nearby wall features a duct-taped Dr. Martens shoebox with a peephole by the artist Ryan Gander; inside is an overturned chair and a tiny velvet rope. Then there's the gleaming faucet from the artist collective Bernadette Corporation. Etched into its chrome surface is the ungrammatical sentence "I wanna see your inside of her vagina."

Unlike many Wall Streeters who collect art, Leong started early. He's 38; just 10 percent of contemporary collectors are younger than 40, according to the 2014 edition of Larry's List, a collector report. Leong is also going about it differently than the typical financier. Most collectors gravitate toward pieces by recognizable names that look good on a wall. Leong has amassed more than 70 works that are conceptual or "difficult"—objects that often require lengthy explanation to understand, let alone appreciate. "I've known him for about three years, and in that time he's already built an ambitious, challenging collection," says Peter Currie, a dealer at Berlin's Galerie Buchholz, which has sold Leong several works. Leong is building a reputation as a collector who's younger than anyone more established—and more established than anyone younger.

Leong favors the standard I-banker uniform of conservative suit and stainless-steel Rolex. He has a B.A. and MBA from Columbia and is a senior vice president in the real estate group at Macquarie Capital. Before that, he spent seven years at Blackstone. Leong began collecting in his mid-30s, when friends introduced him to Thea Westreich, one of the art world's most powerful advisers. (The Whitney Museum of American Art is putting on an exhibition of her collection in November.) Leong was worried that Westreich "wouldn't think I was serious enough," but she was charmed and took him on as a client. Leong was catapulted into a scene of openings, performances, and studio visits. "Having a good adviser helps," Westreich says. "That said, even without me, I think Paul would have managed to find his way into the place he now occupies by virtue of the time and energy he spends looking at art."

Leong "got very knowledgeable about the field in a very short period of time," says Cora Muennich, director of London's Campoli Presti gallery. Buying art from galleries, as Leong does, is more complicated than bidding at auction. As fears of art-flipping speculators have risen, many galleries are attempting to "place" works with collectors they trust won't turn around and sell the art for a profit. Whether there is a horde of predatory millionaires waiting to sweep up young artists' work is debatable; regardless, Leong has benefited from that perception. "He definitely has access to artworks by following our program and artists so closely," says Muennich. "That's one of our main tasks—our artists want to know we've put the work in the right context." And Leong's age is itself an advantage. Not only is a serious under-40 collector a novelty to many dealers, the promise of decades of future business is a powerful draw. Leong needs this special favor, because he "doesn't have a gazillion dollars," Westreich says. "So he has to say, 'Well, if I buy X, I can't buy Y next month.'"

Leong won't divulge how much he's spent on his collection—only "more than I'd like to think about"—but says he hasn't paid more than $90,000 for a piece. Back in his apartment, he's more interested in talking about the theoretical underpinnings of a painting by Jutta Koether than about how it looks. "Understanding her work and following her process is much more enriching than just going to a show and being like"—he does an impression of a collector buying for appearance alone—"'Oh, that's nice.'" Ⓑ

Lutz Bacher

New York-based Bacher has a body of work almost impossible to describe. Her art includes appropriation (such as this tank she found), photography, and video

Wolfgang Tillmans

Tillmans, a German-born photographer, focuses on modernity, graphic sexuality, and everyday banalities

Age **38**

Cheyney Thompson

This work by Thompson, a conceptual painter, deals with economic theory and stochastic models

THE NEW MONEY ISSUE

INHERITANCE

Heir Conditioning

How the superwealthy plan to make sure their kids stay superwealthy

By Peter Robison

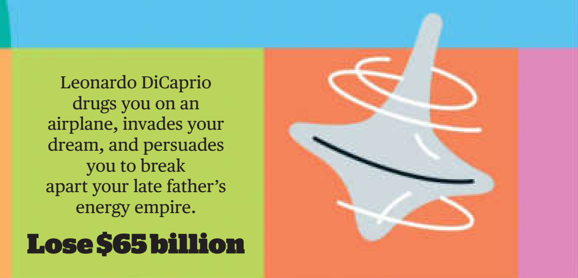
The first clue that this is no ordinary crowd of sulky teenagers comes when the instructor asks those who've invested in the market to raise their hands. Most hands go up. As a financial planner explains the benefits of investing, one boy interrupts. "What do you suggest investing in right now?" asks Liam Whitfield, 18, a senior at a private Seattle high school, with swooping bangs and a shaggy sweater. The speaker, from a local investment firm, suggests a standard mix of 60 percent stocks and 40 percent bonds. Whitfield looks disappointed. He already owns shares of Apple, Facebook, and Starbucks. "I was kind of looking for an actual stock tip," he says.

It's a Saturday morning in March, and Whitfield is sitting with two dozen teens in an antiseptic meeting room for a lesson on money management arranged by their well-to-do parents. The lecturers have broken the ice with a *Saturday Night Live* ad for a book of financial advice called *Don't Buy Stuff You Cannot Afford*. (It's one page long.) They show photos of cars that go from humble to glamorous and ask the kids to pick one—but only after calculating how long it would take to afford by saving $2,000 a year. An instructor praises a girl who chooses a Volkswagen Jetta over a $90,000 Range Rover. "You followed all the rules—it's exciting, guys,

*Not a real game. Inspired by Shirtsleeves to Shirtsleeves, described on the opposite page

right?” says John Gage, a 6-foot-9-inch recent Stanford graduate who roams the front of the room. Gage works for Cornerstone Advisors, a wealth management firm in Bellevue, Wash., that’s hosting the class for children of clients and prospects. During an exercise in monthly budgeting drawn from real-life salaries, someone notes how difficult it can be. “Especially if you’re a teacher,” one kid cracks.

This is the most gilded age since the Gilded Age, with 5 percent of American households controlling 63 percent of the country’s wealth. Decades of stagnant income growth for the middle class contrasts with family dynasties such as the Waltons of Wal-Mart, wealthier than



the poorest 40 percent of households combined. Some $59 trillion—the largest intergenerational transfer of wealth in U.S. history—will flow down from estates through 2061, according to Boston College’s Center on Wealth and Philanthropy.

None of that’s made the rich any less anxious, at least when it comes to keeping their money. The number of family offices for the ultrawealthy has doubled since 1998, branching into areas far beyond portfolio and tax planning. The advisory firms reach deep into their clients’ family lives, aiming to prevent squabbles among heirs and head off early signs of wastrelism. Some teach classes like this one near Seattle or organize family retreats. Others use board games and flashcards to drill sound money concepts into children as young as 5. One firm, Ascent Private Capital Management, employs an historian and two psychologists to help clients put their fortunes and family dynamics into perspective. “We didn’t just want to help clients manage wealth, we wanted to help clients manage the impact of wealth,” says Michael Cole, the firm’s president.

Like others in the business, he brings up an adage—shirtsleeves to shirtsleeves in three generations—and says, “It’s real.” Thought to be a variation on a saying from Lancashire, England, about families going from clogs to clogs, the idea resonates in many cultures. Japan’s version is rice bowl to rice bowl. In Italy, from stars to stall. Or, as the striving executive Jack Donaghy put it on *30 Rock*: “The first generation works their fingers to the bone making things; the next generation goes to college and innovates new ideas; the third generation snowboards and takes improv classes.”

Adviser Roy Williams says he was recently approached by a representative for wealthy Asian families in the Pacific Northwest, each with more than $200 million. “They said, ‘The kids are consuming our wealth, buying Lamborghinis and Bentleys, and we don’t know how to change the pattern,’ ” he recalls.

Williams is the co-author of the ur-text of the field: *Preparing Heirs*, a compact, green-jacketed 2003 book written with Vic Preisser that followed 3,250 families from 1975 to 1995. Their research found that 70 percent of inheritors failed in passing their fortunes on to the next generation. The book defined a failure as “involuntary loss of control of the assets.” The overwhelming reason, they found, was either a breakdown in family communication or unprepared heirs. Just 3 percent of failures were attributed to such issues as taxes or legal challenges. While the book’s data are now decades old and largely precede the inheritance tax cuts that led to such critiques as Thomas Piketty’s *Capital in the Twenty-First Century*, the 70 percent failure rate is still commonly cited by advisers as a reason to engage their services.

“In our experience, there’s no amount of money that can’t be lost,” says Sheila Stinson, until recently director of family education at GenSpring Family Offices in Jupiter, Fla., a hamlet north of Palm Beach that’s been home to Michael Jordan, golfer Rory McIlroy, and Celine Dion. The firm, whose clients are worth at least $50 million each, created the Innovation & Learning Center in 2006 to lead workshops and teach classes.

One of its innovations is a board game called Shirtsleeves to Shirtsleeves that Stinson has played with clients and their children over cocktails or lunch, depending on their ages. Players get money in $1 million, $5 million, and $10 million denominations. They navigate a Chutes & Ladders-like board through obstacles such as: “Your beach house in Malibu has become the place to be for your kids. Even though they’re in their mid-thirties and can’t show up for a family meeting, they never miss the afternoon set. Wipe out! LOSE $9 million.”

For younger kids, Stinson has used a game called Money Matters, which features flashcards showing pictures of material goods. She asks the children to tell her if the item is a “need” or a “want,” something they can do without. She recently showed a picture of a purse to four girls aged 9 to 11. One girl called it a want. Another said no, a Tory Burch handbag is essential.

Ascent, a division of U.S. Bancorp, chose a youthful look for its offices, in Cincinnati, Denver, Minneapolis, San Francisco, and Seattle. The décor is all white, inspired by Apple stores and Virgin America aircraft cabins. In San Francisco, in a 21st-floor suite overlooking the bay, there’s a room where kids can relax while their parents talk to the staff. It has a couch, a white beanbag chair, and an Xbox.

Ascent’s craft has a lofty history. Family offices trace their lineage to 6th century royal stewards and, in the 19th century, advisers who managed art, collectibles, and homes for J.P. Morgan and other tycoons of the era. There are now some 3,000 such firms worldwide, at least half set up in the last 15 years, according to a 2013 Ernst & Young report.

“In our experience, there’s no amount of money that can’t be lost”

Good help doesn’t come cheap. Ascent charges clients a minimum of $200,000 a year. Some don’t keep any money with the firm and only use its ancillary services, Cole says. The firm’s Center for Wealth Impact offers a director of family history and two “wealth dynamics” coaches trained in organizational psychology. The idea is to focus on the breakdowns in trust, communication, and education spotlighted in Williams and Preisser’s book.

Demons lurk for the wealthy, to the point that some researchers suggest that affluence creates a greater risk of depression, anxiety, and substance abuse. In one 1999 study of wealthy high school girls in a suburb in the Northeast, 1 in 5 reported clinically significant levels of depression, three times higher than the national average. Wealthy boys showed more anxiety than average in a study by Suniya Luthar, a professor emerita at Columbia. Later research across the country has produced similar results. Rich kids have to navigate a complicated psychological stew, including guilt over inherited wealth and stress from the pressures of living up to a family legacy.

Ascent tries to head off problems by getting families to think about their mission and purpose, much as corporations do. Amy Zehnder, a senior wealth dynamics coach, says she asked one family’s three boys, ages 15, 19, and 21, to create a visual representation of the clan’s core values. The boys returned with a drawing of a custom Jeep, each part corresponding to a different value. The antenna represented communication; the snowboard rack was work-life balance; the windshield, integrity; the engine, loyalty; the steering wheel, drive; the headlights, respect; the massive tires, ambition; and the lift kit, growth. Their dad was touched, Zehnder recalls. “As a family they made a decision that they were going to go and build this Jeep,” she says.

Cornerstone, the advisory firm in Bellevue, manages more than $3 billion. It taught its first class to three sets of siblings in 2006, after a client asked for financial instruction for her sons. Managing Director Sue Peterson went to a Barnes & Noble and found books for toddlers about quarters and dimes, some Suze Orman financial titles, and little else. Peterson developed her own curriculum, eventually expanding it to a half-day of lessons on budgeting, credit cards, and investments. Parents spend the time in their own session, comparing notes. “How do you teach your kids about how fortunate they are?” Peterson says. “If you drive past Bellevue High, most of the cars pulling into the parking lot are nicer than mine.”

Liam Whitfield’s mother, Diane, heard about the class through a friend of her husband, Bill, a real estate investor. The family lives in Broadmoor, a gated enclave with a private golf course where the median home lists for $2.1 million. The Whitfields have three sons: Liam, Stanley, 16, and Trammell, 8. They’d been thinking it was time for their older sons to start taking more ownership of their finances, Diane says. Liam might pay for all his friends to see a movie, while Stanley might spend his lunch money on video games.

“Just as much work goes into these kids that have money coming their way as kids that don’t,” she says. “The psychological component is huge: How do they mix with their friends? Do they only hang out with kids who have money?” Most of all, she’s tried to explain that with wealth comes responsibility. Whitfield was drawn to a famous tale of a man who brought his salary home in dollar bills to show his children where the money went. “You know when your kids say, ‘Why don’t we have a pool?’ ” she says. “It’s because, well, we’re choosing to take you to Europe instead.”

After warning them that, yes, it might be a few hours of total boredom, she brought Liam and Stanley to the Cornerstone course. For Liam, who entered college this fall, the class was part of preparing to live on his own; his parents later asked him to write a budget for the summer. He’s sometimes had awkward situations with friends. “I don’t carry cash on me, because I don’t like it when someone says, ‘Oh, Liam, you can afford it, so you should pay for it,’ ” he says.

As his persistent questioning in class showed, Liam is ready for more. He says he hopes to start joining in on family foundation meetings soon. An Eagle Scout who also swam, played football, and went to the district championships in shot put, he wants to become an orthopedic surgeon. He plans to take premed courses at Westmont College in Santa Barbara, Calif., the school where his parents met. He’s found that too many kids of his generation, used to instant gratification from social media, find it easy to coast.

“We have everything at our fingertips,” he says. “It’s absurd, actually.” Ⓑ

The Global Barista Survey

In cities around the world, coffee shop employees tend to have certain traits in common. They're young. On the edgy side of stylish. And probably not in their dream job. What does the future look like to the espresso-pulling set?

Shanghai

Age 25

Yanan Zang
1,000 yuan ($157)

Are things getting better or worse for you? Better. I'm getting to know more people through this job, and they ask me to do drawing or design work on the side. **What would you do if you got a windfall?** Travel. It's not that important where, just somewhere beautiful.

Athens

Krystallia Ninou
Weekly take-home pay: €200 ($224)

Are things getting better or worse for you?
I'd be doing better if we weren't in an economic crisis. I used to make much more. Clients don't have as much money, so they don't come as often, and there's been a huge decrease in tip money. Also, employers use the economic crisis as a viable excuse to lower wages.

Age 24

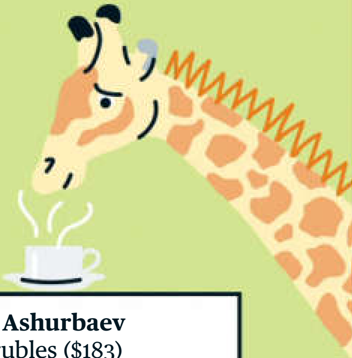
PHOTOGRAPHS AND INTERVIEWS BY: EIRINI VOURLOUMIS, ATHENS; ALBANO GARCIA, BUENOS AIRES; IGOR STARKOV, MOSCOW; ADRIANE OHAN, NAIROBI; ERIC MICHAEL JOHNSON, SHANGHAI

Nairobi

Age **24**

Peter Ochieng
3,750 shillings ($36)

Where do you see yourself in five years? I'm sure I'll have my own company. I'm always thinking up new ideas and trying to do something different. I'd like to create my own products, like a clothing line. But that's just one idea.
What would you do if you got a windfall? My business would be started tomorrow.



Ruslan Ashurbaev
12,000 rubles ($183)

Are things getting better or worse for you? The dollar increased, so for sure it isn't good. Everything changed in this country, absolutely everything.
Would you rather live somewhere else? I do not care where I live. The more important [question is] how a man can set his life. Anywhere, you can find your place.

Age **23**

Moscow

Buenos Aires

Age **21**

Viviana López
1,700 pesos ($181)

Where do you see yourself in five years? I would like to be a teacher—a university teacher in communications. But also I would like to keep being a barista. I love everything related to coffee.
Would you rather live somewhere else? Right now, I like Argentina a lot, and I want to try my luck. But I'd also like to know Canada. I like the ambiance.

And Now for Some Advice From Very (Very, Very) Old Money

It's one thing to get rich, another to stay rich. And it's something else entirely to safeguard family money for more than five centuries. Founded in 1521 by Jakob Fugger—aka Jakob the Rich—Germany's Fugger Foundation has endured plague, famine, two world wars, the Internet, and the euro. Today, the organization's eight charities still dole out alms and maintain churches, while innumerable entities—rival families, countries, entire empires—have fallen. Reached while recovering from a horse-riding accident at Schloss Oberkirchberg, a castle purchased by Jakob, the Countess Maria Elisabeth Thun-Fugger, 66, the foundation's chair and de facto spokeswoman, shares a few lessons about longevity. —*By James Tarmy*

Start with unimaginable wealth

Jakob endowed the foundation with a stake in his business. How rich was he? *The Richest Man Who Ever Lived*, a new biography by Greg Steinmetz, describes a lender and entrepreneur who strong-armed sovereigns, popes, and other lesser men, amassing a fortune then worth 2 percent of Europe's gross domestic product.

Don't sweat liquidity

"The most brilliant thing we ever did," Thun-Fugger says, "was to convert our assets from cash to property." That looked especially smart during the hyperinflation of the Weimar Republic, when \$1 could buy about 4 trillion reichsmarks. Thanks to its landholdings, the foundation thrived.

Lobby God

The foundation's crown jewel is the Fuggerei, a planned community for the needy in downtown Augsburg. It still has more than 150 residents. Original tenants were required to pay 1 gulden per year—about a week's pay—and pray for the Fugger benefactors. The cost has since dropped to €1 (\$1.12), but the prayer requirement, the countess confirms, "has not changed."

Keep the family honest

All three branches of the clan have board representation. "If one person has a crazy idea, then the other two can correct it," Thun-Fugger says.

Ignore fads

"I asked our archivist if there was ever a big scandal, and he said no," Thun-Fugger says, "though sometimes they did whatever was fashionable. For example, at one point, everyone with our type of property had a brewery." The Fuggers, who once brokered the sale of indulgences from the Vatican, turned out to be poor beer vendors. "They had to shut it down," the countess says. "But there was never a situation where there's been mismanagement and we've lost half of our assets."

Keep chipper during wars

The Fuggerei burned down in the 1600s, during the Thirty Years' War; three centuries later, Allied bombers leveled half the homes. Both times, the foundation started over. "The second world war was not yet over," Thun-Fugger says, and family elders "were in their bunker and decided to rebuild. They said, 'The whole country is in ruins, but nevertheless, we're still going to go for it.'"

Resist hostile takeovers

A modern dynasty might have to deal with Carl Icahn. The Fuggers have fended off Napoleon and Hitler. When each dictator controlled Germany, he wanted to absorb the family's property into the state coffers. Says Thun-Fugger: "I guess we were lucky to make it through all of that."

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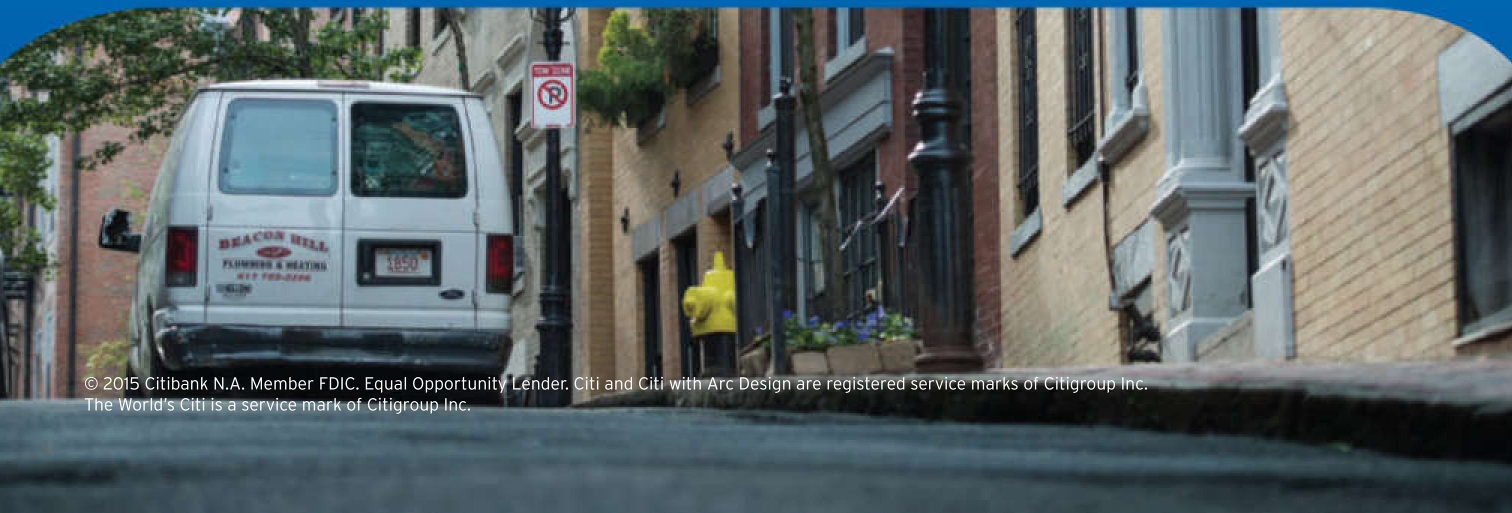
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